

UNITED STATES OF AMERICA

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FEDERAL CREDIT INSTITUTE

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PROMISING PRACTICES WORKSHOP

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WEDNESDAY

OCTOBER 2, 1996

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The Workshop met in the G.S.A. Auditorium

at 18th and F Streets, N. W., Washington, D.C., Thomas

Frank Kesterman and Thomas Stanton, Moderators,

presiding.

PRESENT:

FRANK KESTERMAN	Moderator
THOMAS STANTON	Moderator
ANN BAIRD-BRIDGES	Speaker
PATRICK BERBAKOS	Speaker
GAIL BEYNON	Speaker
MARK CARNEY	Speaker
MARTIN COOPER	Speaker
GEORGE FRENCH	Speaker
KENNETH GOULD	Speaker
NELL HENNESSEY	Speaker
KATHY KUL-INCLAN	Speaker
JEFF MILLER	Speaker
DENNIS PEACOCK	Speaker
MEERA RAMACHANDRAN	Speaker
CARL WASSON	Speaker
LAURA YEAGER	Speaker

CYNDY ZEMITIS

Speaker

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MODERATOR STANTON: Welcome to the second day of the Best Practices Workshop. There is bad news, and there is good news. The bad news is there are so few of you people, and thank you all for coming, because judging from yesterday's interactions, the quality of the workshop is when an agency gets an idea from watching the experience of all the other agencies.

The good news is that it will be done. This is going to be a transcribed session, and in fact there are a number of us in government and advisors to government, as I am, who in fact are planning to proceed with implementation of a lot of this.

I mean, these are wonderful examples. We had one superb speaker after another, yesterday, and these ideas deserve to be implemented, where they are appropriate, across government.

So what we have this morning, is really a take-off from yesterday. Where we ended yesterday, with service or monitoring, was a consensus, at least among some of us, in an informal romp session over the coffee machine, that Ginni Mae was the state-of-the-art in service or tracking, in originator tracking, in figuring out what part of all of those wonders that are out there, or for education, read schools, that are out there, that in fact involve the highest degree of financial risk.

Ted Foster, from Ginnie Mae, who deserves rightfully to be proud of both IPADS and CPADS, the Ginnie Mae systems that are exhibited out there, told us that in the 1980s, Ginnie Mae took a two billion dollar hit in terms of claims that they had to pay.

They all sat around in a room and asked the question, where did it come from, what should we do to deal with this kind of thing in the future? IPADS and CPADS are a wonderful first step towards answering that question. This morning's session, where we borrow from non-credit agencies, not that each of the speakers here today, will be a non-credit agency, is the next step forward. Financial early warning systems, can analytically, get a glimmering of problems that are going to develop before they actually materialize.

Ultimately, the ideal would be, as we had in the discourse with the Freddie Mac representative yesterday, that we might actually want authorization for government programs to adjust underwriting standards, to be able to be truly proactive in what they do. But what we have to learn, this morning, which is essential as the next step for federal credit programs, is the nature of financial early warning systems that have been developed by the Federal Deposit Insurance Corporation, starting at the end, the Federal Reserve, the Home Loan Bank of Chicago, and the Pension Benefit Guarantee Corporation.

Can we agree among ourselves on any order, or are we just going down

the table? Well, whatever it is, who is first? George French from the Federal Deposit Insurance Corporation. Go for it.

MR. FRENCH: Thank you, Tom. I'd like to thank you for the invitation to participate, and also to Frank Kesterman for inviting us here.

I'm going to be talking down there, anyway, so somebody needs to turn the projector on. Unlike some of the other panelists, I'm not going to be talking about any particular financial model, or scoring system, this morning. I'm basically going to be talking about a set of operating procedures that we have developed at the Federal Deposit Insurance Corporation (FDIC) for monitoring risks to the banking system. While I don't have a particular model to talk about, I do have an acronym, which is DOI, Division of Insurance. The Division of Insurance was established in 1995 for the purpose of monitoring and identifying risks to the insurance funds.

So basically the first priority of the division is to monitor risks in the banking system. And the second function of the division is to manage the FDIC's risk-based premium system, which assigns premiums to banks based on the risk they pose to the insurance funds. We have made a conscious effort, in doing this, to blend expertise from a variety of disciplines. Bank examination, economics, failure resolution and asset disposition, and capital markets. We think that this blend of experience is important in bringing a number of perspectives to bear on the identification of risk in the system.

In doing our job, we have sort of identified a number of general operating principles, one of which is the importance of communication between people out in the field, who are examining banks, on a day by day basis, and the analysts that we have in Washington, and in the regions. Our Chairman, Ricky Helfer has called this process "bridging the gap." In other words, there are people out there who go from bank to bank, looking at each bank on an individual basis, very micro-focused, and then we have economists and analysts who are responsible for looking at broad trends, regional economic developments, and so forth.

Typically those two groups have not communicated a whole lot, and not talked to each other very much. They've each sort of gone about their business. The idea of the Division of Insurance is to enhance the communication between those two elements, and try to identify risks in the banking system from more of a macro perspective, sort of looking at the forest, rather than the trees, in a sense. So in order to do this, we have a set of regional offices throughout the country, cities are shown up there, and these are integrated in with our Division of Supervision.

We have bank examination offices in these eight cities, and sitting right with them, we will have regional economists and regional analysts, sort of in day-to-day contact

with them, so we can get an idea of what the trends are in the banking system from those who are seeing them first-hand. At the same time, hopefully, we can provide the examiners with some useful analyses on what is going on in the regional economy that might be worth thinking about from a bank examination perspective. We have also decided that it is very important to sort of have a very systematic process for how we identify and analyze risks.

It is important, we think, to cast a very broad net in terms of identifying issues and risks for analysis. We don't want to get into the trap of just looking at whatever is the hot issue of the day, or looking at something because that is what the Chairman is interested in, or whatever. We want to sort of deliberately seek out what is going on in the banking system that we need to be aware of. We have weekly conference calls with our eight regions, all participating at the same time, and our Washington analysts; what are you seeing this week, what are the issues that have appeared?

People are looking at a variety of information sources. Based on these conference calls, and sort of looking at the broad set of issues out there, we've identified topics for possible further analysis. So we develop sort of a list of potential risks in the system. We have somebody do kind of a preliminary analysis of the issue. An example might be the retail industry. You hear a lot about problems with over-storing, or whatever, excess space in the retail industry.

So we have somebody look into kind of the broad trends, the trends and growth in space relative to indexes of demand, demographic trends over a long period of time, looking at the characteristics of what kinds of stores seem to be having problems. There are a lot of sources of information out there, which we at the FDIC traditionally have not looked at. We traditionally look at our "call" report information, and our bank examination reports.

To some extent we close our eyes to the rest of the world, and any information sort of -- whatever hits us in the face, we are going to try to be more systematic in digging into particular issues, in this case, the retail industry, and ask whether there is something there that needs to be looked at. So at that point, if we decide that there is something that we should be looking at, we go to sort of a published newsletter approach. An example, one we are working on now, is credit scoring for small business lending.

We hear that there are a lot of banks out there, some big banks who are basically doing the same approach with small business lending, as a number of banks have done with credit card lending, which is to have sort of very expedited application process, you know, one page applications, no financial statements, et cetera. That there are some big banks on the west coast that are gobbling up market share. So this raises the issue, you know, is there an insurance risk here, any sort of long-term concern about underwriting standards, credit quality, what have you.

We want to look into that issue, and the way we do that is we talk to the people out in the field who are examining these banks on a daily basis, and we talk to

companies with expertise in developing these kinds of models. We look at a variety of sources of information, and try to get a handle on what is going on.

And, finally, for certain issues, we will sort of do a very intensive analysis. For example, consumer credit, we would do a lot of work on something like that, and present something to our senior management, or maybe a published report, something along those lines. Obviously, for something like this, you are going to need to get a quantitative sense of what the risks out there are.

One of the important things that we try to do, and we are trying to continue to do, is to develop ways of estimating the exposure of the insurance fund. In particular, we are working on a number of stress testing models for the banking system, for particular banks. What will happen if certain performance drivers of the bank, credit quality or net interest margin, or whatever, how sensitive is a bank to deteriorations in those types of performance drivers?

We can sort of look at historical experience relative to, you know, specific asset types, specific loan types, charge-offs, or non-performing assets, and estimate how many banks out there are sensitive to a two standard deviation event, relative to credit quality, or that type of issue. Another thing that we are interested in, and it is going on in other divisions at the FDIC, as well, is the general question of how you estimate the sensitivity of bank performance to changes in economic conditions.

I imagine there have been a number of people at the Federal Reserve System who have been looking at this issue, the OCC, probably, and I don't think anybody has really completely analyzed the question to their satisfaction, but we are very interested in this question, too. So if there is anybody out in the audience or on the panel who has experience with the -- or if their agency is working on any of these issues, we would be very interested in hearing from you, and hearing about your experiences with these issues.

All these general operating principles come together, as an example, in our regional reports, which we hope to get our first set of eight regional reports out by the end of the year. The regional reports would focus on how the financial and economic trends in the region might affect FDIC insured institutions. We are trying to take a narrower focus, for example, than with the Federal Reserve. The Federal Reserve is interested in the whole economy, and monetary policy and all those big issues, and we are more interested in what is the effect of all these things on the banks and thrifts that we insure.

In particular, the FDIC of course, is very focused on the outliers, and the worst, you know, the worst five percent or the worst two percent of the industry. We have a slightly different and somewhat more narrow perspective. And that is, what is the effect of these developments on the insurance fund?



So, for example, we might be looking at construction activity in a particular metro area. How is the growth in construction compare to the growth in demand and economic conditions in the region; are we getting an over-building situation? So the idea is, ideally, if the Division of Insurance had been in place in the 1980's, maybe we would have had a slightly earlier indication of emerging problems in areas like the southwest or New England. At least that is the theory that we are supposed to be there, looking for these kinds of problems.

Another example, we might have people looking at the agricultural conditions in the Chicago region, how many FDIC field offices have banks that are exposed to agricultural problems, crops being planted late, or what have you. The main focus, here, or one of the most important focuses is on very close contact with the bank examiners. What are the bank examiners seeing when they go into these particular institutions, and what are their concerns?

Is it commercial real estate loan growth, or non-bank competition, or the ability of the institutions to compete technologically? Okay, so we are looking at a lot of issues and trying to identify risks in the system, and then one of the questions that is always asked, what do you do with the analysis, once you've identified a risk that is out there, how do you respond to it?

And that is sort of -- that is an important question. And one sort of general answer is that the information is valuable, in and of itself, it provides examiners and bankers and FDIC senior management, it gives them another way of getting a handle on what are the broad risks in the system that they are facing, what are the issues they ought to be looking at when they go in to examine a bank, et cetera.

As far as what the FDIC would do with this information, apart from explicit supervisory action or examination action, you could say that simply reporting that there is a risk in the system, and sort of getting up on the pulpit and saying where a particular area is a concern may be of some value in alleviating the problem.

And, finally, we do have the authority to price insurance based on the risks that we see. And so to some extent, down the road, this kind of analysis might factor into the FDIC's risk-based premium system. That is the end of the presentation, and I look forward to hearing from anybody, afterwards, who might have any insights into any of these topics.

Thank you.

MODERATOR STANTON: Thanks very much, George. We will have questions, and I think Ted is in the back of the room, so this one is for you, Ted. Now would the panel like to say who is going next? Ken Gould, the Executive Vice President, Federal Home Loan Bank of Chicago.

MR. GOULD: I am going to use some overheads, so is there a live

mike over here that I could use?

MODERATOR STANTON: Yes.

MR. GOULD: Good morning. It is very nice to be here and talk about credit. A lot of the same ideas that came out of the FDIC's presentation will come out here, and hopefully you will have a chance to see how credit is administered when we are making large loans. And that is what the Home Loan Bank does.

Let's start off with the first idea that this report is a three-part report. And we have the next -- this is a three-part report. The first is, what is a Home Loan Bank, what do we do? Second, what is so special about Home Loan Bank Credit? And the third is, how does the SIGNAL monitoring system, how is it constructed, and what value does it add in that process?

What is a Home Loan Bank? Well, from a regulatory standpoint, a Home Loan Bank is a government-sponsored enterprise, created in 1932 to foster housing finance. From the standpoint of the financial markets, Wall Street, we are an issuer of bonds, rated AAA-AAA, for which we are jointly and severally responsible.

That is to say the capital of my bank is lumped together with the capital of all the Home Loan Banks, and would be used to pay any defaults on bonds. From the standpoint of the management of these banks, the Home Loan Bank is one of twelve banks, each independently operated, with independent credit policies, with different membership patterns, and therefore different credit needs, different analytical needs.

From a standpoint of our customers, who are also our owners, everyone who is a member of the Home Loan Bank owns stock in the Home Loan Bank, and only those who are members and can borrow are allowed to own stock in the Home Loan Bank. So from the standpoint of that important base, our customers and our owners, we are a major source of liquidity and mortgage funding.

Who are these owners? They are banks and thrifts across the United States. How big is the Home Loan Bank, how important is it to the financial markets? One of the ways to look at this is to think about GSE's in general, and about bank holding companies, some of which we are pretty familiar with. If you look at this chart, you see that Fannie Mae tops the list of the 12 bank holding companies and GSE's that are the largest.

But the Home Loan Bank system, the 12 banks together, are nestled comfortably in third place, in between the New Chase and Citibank. I mentioned that Home Loan Banks are owned by their members. That ownership is a substantial financial obligation. Our members have capital of 14.7 billion dollars. We paid dividends in 1995 of 916 million dollars. It is that source, that capital, and that earnings flow that is at risk if we don't do credit well.

Well, all right, how well are we doing? One of the ways to measure that is to find out whether anybody wants to belong to the Home Loan Bank. And, as you can see, if you can see this chart, the Home Loan Bank has moved from 3,000 members in 1989 when FIRREA was passed, to 5,991 members now, a pretty substantial growth.

That growth, however has been accompanied by a change in membership. The Home Loan Banks started out to be nothing but thrifts, we were exclusively thrifts, as members of the Home Loan Banks. FIRREA allowed commercial banks to become members, and the green section of that chart represents the commercial bank membership. As you can see now, that membership is roughly 65 percent of total members, up from zero in 1989. So obviously Home Loan Bank credit is attractive to banks.

There is a little difference, though, between banks, commercial banks and thrifts, and it is very important to Home Loan Banks. By law, we are required to be fully secured lenders. That is to say, we cannot lend to somebody on their signature, we must have collateral. The collateral that supports our mission is one to four family residential mortgages. The pattern of one to four family residential mortgages differs greatly, the pattern of holdings differs greatly between thrifts and banks. The green graph line on the right of that chart represents the pattern for thrifts.

The most common holding is roughly 50 percent of the thrift's total assets. We have some thrifts that only hold 10 percent of their assets in mortgages. This always surprises people, they have a lot of things, in mortgage backed securities and other sources. But within mortgages, themselves as you can see, there is this distribution, but it centers over 50 percent of their assets. These folks are in the mortgage business, they are committed to it, they are going to have the collateral that we want, at all times, and historically that has been the people to whom we've lent.

On the other hand, recently 65 percent of our members have become the folks on the left, which are centered around 20 percent of their assets in mortgages. In addition, over the past 10 years, mortgages have become much more portable. As a result, keeping track of the collateral, and making sure that you really are a fully secured lender has become a little trickier. Therefore, the idea of credit worthiness has become more significant. If you can't keep track of the collateral as well, you must be sure that the person to whom you are making the loan is worthy of receiving it.

All right. We've had a lot of growth in numbers. How about borrowers? Any of those folks borrowing? And the answer is yes, they are. The system started off with about 1,800 borrowers. In 1991 we were down to 1,256, we hadn't figured out how to get banks to borrow. We could get them to be members, but we couldn't get them to borrow. And the thrifts, of course, were being combined, merged, and in other ways were stopping their borrowing. Since 1991 we figured out how to talk to banks and make ourselves important to them, and in fact their borrowings have now risen to roughly the same rate that we had for borrower participations when we were strictly with thrifts.

So what has happened to advances? That is what we call our loans, advances. We had 142 billion dollars worth of advances in 1989, primarily to thrifts in economic difficulties, who could borrow from no other sources. As you can see, when FIRREA came in, we had a very large decline in the amount of advances outstanding, down to 79 billion in 1991. And then as borrowing began -- as capital began to get better, and as banks began to figure out the use of the Home Loan Bank system, we are now at 149 billion dollars worth of credit outstanding. That is a lot of credit.

FIRREA changed the Home Loan Bank's role in many fundamental ways. Prior to 1989, we had mandatory membership. If you were a thrift, you had to belong to the Home Loan Bank system. After 1989, we are primarily voluntary membership, the market decides whether it is of value to belong to the Home Loan Banks. Prior to 1989 we had a role just like the FDIC's, we had examiners, we were talking to management, we were deciding whether a thrift stayed open or did not stay open. And we had great sources of information, it was wonderful.

Now, we make 149 billion dollars worth of loans, just like any other non-examining body, so credit becomes more important; the ability to analyze credit and to see how to predict those credits that will be of value five years from now, because we make long-term loans. Another thing about the Home Loan Banks, we will make loans up to five or ten years, which is a long time for a financial institution. We are -- prior to 1989, we were the primary source of credit for our members. Thrifts did not generally access other credit sources, they strictly borrowed from the Home Loan Bank, and had deposits.

When you have commercial bank members, they have a wide source of borrowing alternatives, and so you are in competition with many other lenders, and that also affects your credit analysis. This, I always like this slide, because this is where we are so different from everybody else. The Home Loan Bank is unique in its operating margins. When you look at a commercial bank, you will see operating margins of 300, 400 basis points, where they are between -- the difference between what they earn on their assets, and what they pay for the funds that support those assets. In our case, that is not 4 or 500 basis points, it is 59 basis points. That is less than banks are expected to bring home on their bottom line.

How do we survive with those narrow margins? Well, our costs are also very low. Where you would expect to have 250 or 300 basis points of expenses in a typical commercial bank, for us the figure is 5 basis points. We don't think you see that number anyplace else except the Home Loan Bank. And it is not a mistake, that is the real thing. But, the interesting thing about that number is there is no room for a reserve for loan losses. A Home Loan Bank can have no losses. Our margins simply would not support it.

In fact, the good news is, since 1932, we have not had any losses, not one. And the way we do that is to administer credit. But no room for credit errors. All right, we talked about the Home Loan Bank system, what it is, and we talked a little bit about what is

unique about home loan credit. The Chicago Home Loan Bank, being independently operated, has its own credit policies, and we had some key concepts about how we approach the business.

One of them is that there is a separation of the banking and credit functions. Bankers are responsible for recruiting members, convincing people to buy stock and go to their board of directors, and get them to sign papers authorizing them to become members of the Home Loan Bank. The banking group is also responsible for generating advances, for bringing in the business. The credit department is responsible for preventing losses. The key credit idea that falls out of that is that you have to have early identification of unfavorable trends, and you have to have a reliable indication of member credit status. How have we dealt with that, with all of the changes that have been going on since 1989? Well, there have been four phases of our approach since 1991.

We started out with everybody else thinking about capital ratios. When there is no capital in an industry, as there was no capital in the thrift industry in the late '80s, you search for those that had some real capital, because those were the ones that were safe to make loans to. That was the basis of our program. But as FIRREA became effective, and as financial institutions all began to build up their capital, their use of reported capital became less of a discriminator. All of our members met their capital ratios. All of our members became well capitalized. So now how do you pick which ones to talk to? How do you pick which ones to look at so that you know how to use your credit resources?

Secondly -- so we went to a thing called adjusted capital ratios, and we worked with that for a couple of years, we went through a thing called -- that we called historical trend analysis, and finally to the SIGNAL scoring system. And I'm going to talk about each one of those in order. Adjusted capital is a concept that we came up with in 1993. It focuses on non-performing assets. The actual author of the adjusted capital approach is Richard Randall of the Boston Fed, and I'd like to give Dick a lot of credit for this.

In 1989, in the New England Economic Review, he published an article, "Can the Market Evaluate Asset Quality Exposure in Banks; Can it be Done?" He followed that up in 1993 with an article that was perhaps a post-review, the answer to the question of his 1989 article. "Lessons from New England Bank Failures." And what Dick -- the insights that Dick had, the key credit idea, is that non-performing assets are more predictive than capital, particularly in stressed markets.

If you will study the non-performing assets, you will get an early warning of what is going to happen to a bank's capital in three, four or five quarters, depending. And one of the reasons for this is that in stress markets it is harder for regulators to deal with the financial problems, so they linger longer, you have more time. This was a very important idea, we

thought it was very predictive, and we thank Dick for coming up with it. He had a second idea; eventual write-offs are frequently greater than the reported non-earning assets, at the time that the non-earning assets get high enough to get on your radar screen.

Now, everyone, before that, was always taking a percentage of non-performing, saying, well surely not all of these will be bad. Surely we will be able to resolve some. Well, the evidence demonstrated to Dick that in stressed markets, frequently the non-earnings, non-performing loans are building over time. And that the actual financial result is that the write-offs are higher than the amount of non-performing loans, when you first start to notice that they are significant. And that is an important insight.

Finally, Dick looked at book capital, and credit ratings. And he said, both of these are lagging indicator, indicating that the market was focusing, and the credit worthy agencies were focusing on reported earnings, not on the asset quality that was going to drive future earnings. We think all of these were good insights, so we said, let's use them. And, indeed, the adjusted capital analysis, we believe, is a superior methodology. When we put it into place that adjusting reported capital for non-performing earnings, suddenly 5 percent of our members popped out as interesting people for us to talk to.

This is the same practice the FDIC is also looking for. Our credit discussions became more focused, and less controversial, because our members understood exactly what we were talking about, they could see the equations, they could understand, in their own business, non-performings can translate into weakened capital. Interestingly enough, because the adjusted capital concept brings one to conversations early, credit usually continues. We are not out there to try to cut credit off, we are out there to try to work with our members to make sure that their practices are consistent with their borrowing from Home Loan Bank, which can afford no losses.

What we do is to have quarterly reviews and monthly reporting. Our members are identified by our screens of any kind. We start a quarterly review process that is relatively intense, and we have monthly reporting, where we check on the collateral with more frequency than we would otherwise.

If no improvement occurs within agreed time frames, then we demand the delivery of collateral; for mortgages we'll frequently operate on a blanket lien basis where the member gets to retain its mortgages. If there is no improvement of the member's financial condition, as a result of the conversations we are having, then we ask for the mortgages to please be delivered to us, where we can get them in a secured fashion.

The result is substantially improved analysis. Well, that was good, we liked that, and it worked very well, the adjusted capital concept. But, as we began to notice our members with their new capital, getting into new ventures, credit cards, commercial financings, any number of different kinds of activities that would allow them to use their capital more efficiently, we began to ask the question, how can we know more about these members?

We had been downloading information from their "call" reports to come up with our adjusted capital numbers. And what we decided to do was to expand that download significantly. And we built a database that we update quarterly. We load 1.2 million data items every quarter, we are loading the complete call report for all 1,500 banks and thrifts in the Illinois and Wisconsin areas. Those are the states that we serve at our individual banks. We look at all of the banks and thrifts that are outstanding. We do that for two reasons. The first is to establish pure norms in our district, and the second is because we are constantly recruiting new members, we will do about 100 new members every year.

Every time there is a new member we, in the credit department, have to analyze that member. And we say, we want to know what is going on, we want to see some history on that member. One of the things we did was to calculate 17 ratios. We downloaded three years worth of information, which was a lot of fun to do. And we did it all automatically, thank you. The machines are very formidable now, and the source of the data are very interested in giving that information. You have Sheshunoff here, they'd be glad to download information to you, very inexpensively, as a matter of fact, and they get the call report information. What we download is, we develop a three-year history in the beginning, and now we've had the system for two years, so now we have a five year history.

We calculate seven ratios, and each quarter we run this data through certain tests, looking for capital declines, negative earnings, increased non-performings. This became a better way to look at credit. I'll show you a sample of one of the sheets. You can see that the top section is an asset listing. The second section is liabilities, the third section focuses on earnings, and then the 17 ratios are down at the bottom. The focus is cleverly designed so that you can copy all of this in detail, I'd be glad to talk to you about it if you want to call me. That worked very well. That is a credit officer's dream, to be able to have that kind of information, be able to look at the trends that an organization has, and it was very useful for the credit department, but it was not as useful in dealing with members, having good discussions with them, working with the bankers so they can see who were the best prospects for new members.

It is more attuned to a credit person's perspective than it is to the rest of the bank. So what did we do? We said, we'll develop a model that has this information contained in a simpler way, easier for people to understand. That model is SIGNAL, which is the next step in what we hope is our improved credit analysis and SIGNAL is first and foremost not a credit score. There is no pass/fail.

What we are looking for is to have SIGNAL tell us who should be on our radar screen, who should be the people that we are looking at, so that we can have these conversations. We only have 600 borrowers at any given time, and it is important for us to treat each one of them individually. So this is not a pass/fail, you neither get credit or don't get it model. The aim is to provide the early warning based on multiple factor analysis. A low score triggers the discussion. It is designed to mirror future credit ratings. We hope to be able to predict, through SIGNAL, what the credit agencies and the government regulators will be saying about these banks and thrifts in two or three quarters.

We believe that if you look at these trends carefully, you can see that happen, if you build your model correctly and have the right factors. We use the historical analysis data that was developed. Once we had that data in the database, somebody got creative and said, what can we do to make this better? What are the factors in SIGNAL? There are six. One is the size of the institution involved. Its size based on their capital. And the concept here is simply that if you don't have very much capital, a single shock can exhaust your resources and take someone who looks like a very valuable candidate, and make him a basket case. So for the very small institutions, size is very important. Income is important. We measure it over two years. Grading is a little tricky. Grade is what the various rating agencies say, and we try to build them all in and give it a rating.

One of the reasons for this is we just want to make sure we are always conscious of what others are thinking about with our members and we look at a lot of different rating agencies. There are many available out there, it is surprising. Every segment of the market has somebody who is rating them. We also do network asset quality and liquidity, again, using this published financial data in a predictive way. Ratings for each factor incorporate experienced credit officer judgements, not judgements just from within our bank, but credit officer judgments from large commercial banks and other places where we visited to find out what their decision rules were. That is the name of this game, to figure out which decision rules are predictive, which decision rules result in interesting cases coming up on your radar screen.

Well, how does SIGNAL work? It provides improved differentiation. We are up to five categories, we formerly were able to differentiate among three categories, and now we have five active categories into which we put our members. Secondly, we are down to a point where there is no argument about who is in the top tier. Decision rules that place people in the top tier and the bottom tier are very clear, and within our own bank, there is no question that they are accurate and predictive.

We still are discussing the differentiations in the second tier and the third tier. We are trying to get our decision rules honed so that we can feel very comfortable about what makes somebody a second tier versus a third tier member. The key credit idea here, is that attempts to explain the scoring patterns force the analysis of the decision rules. And, folks, that is to me the biggest part of all of this. The model is fine, but it is the human thinking that goes on as a result of the model, the neural network that goes on right up here, in people's foreheads, that is the real value of this process.

The model is not designed to tell me what to do. It is designed to help me think about what I need to do. And that is the way we approach it, and that is the way I advocate that you approach it. How does SIGNAL work? Well, what do we think has happened? We think that SIGNAL reveals negative trends earlier. We think the use of the model and the building in of the decision rules requires you to think about somebody earlier than your heart might want to think about them. We think that there is improved differentiation, and that there is improved credit rating consistency. And, finally, that all bank personnel are aided in understanding the credit decision.



SIGNAL takes this complex decision process and reduces it down to a number, a single number, but six factors that each have numbers associated with them, and this helps even non-credit people think about credit, so that when bankers have to go to customers that they've just persuaded to join the bank and buy stock, and say, well look, your credit is going to be administered in a slightly different way, it is easier for the bankers to do that. So we think that there is deeper analysis and better credit judgments as a result of the use of this model.

I thank you very much for letting me talk, here, about it.

MODERATOR STANTON: Thanks very much, Ken.

Now Nell Hennessey, who is the director of negotiations for the Pension Benefit Guarantee Corporation, will talk about an idea that I guess won a couple of prestigious awards.

MS. HENNESSEY: Welcome all of you who braved the inclement weather to come out and hear us talk about ways to protect against a variety of credit risks. We are kind of an unusual agency. I was pleased to be on the panel with George, because we describe ourselves as sort of the FDIC of pensions since the FDIC is a household acronym, and the PBGC is a less well-known.

In the "Common-Sense Government Report" issued by the National Performance Review last year, we were -- we came under the heading of "Why we have a Federal Government" and that pleased us, but it also illustrates one of the problems that we face. We insure the uninsurable. Pension plans are very like life insurance annuities. They offer lifetime benefits at retirement. We ensure those benefits. However, we have no control over solvency, unlike the typical credit regulatory agency, there is no pension regulatory agency that can require that a pension plan be funded.

No one controls the ability of an employer to set up a pension plan. The system is involuntary. If they set it up, they have to pay premiums to us, but the converse is also true. We have to take them and, interestingly, we ensure them, even if they fail to pay the premiums. It is one of the interesting involuntary servitude aspects of this whole arrangement. We started in 1974, the Employee Retirement Income Security Act was passed, because Richard Nixon was impeached, which was one of the interesting historical artifacts. We were the first piece of legislation that Gerald Ford signed, he wanted some good news for Labor Day, to take people's minds off what had just happened.

So we started in a turbulent time, for a variety of reasons, and we

started in a peculiar fashion. We had to ensure risks before we began to collect premiums and so for the 22 years of our existence, we have labored under a deficit. We have labored under a deficit, financially, and we have labored under a deficit in the sense of workload, because we have always been running behind the number of pension plan failures. When you look at the pension insurance system, and when Congress set it up originally, what they thought they were doing was creating a means to ensure pension plans. When you think of insurance, you think, okay, that is the risk that you are ensuring. It turns out, over the last 20-some years, we've realized that what we are really insuring is bankruptcy, and that is an uninsurable risk.

When I was a young attorney, I'm back for my third stint at this agency, because it is a great little agency. But when I was a young lawyer, when I worked for the agency, we talked to a bunch of credit rating agencies, and they said, we don't -- we talked to bonding, the insurance companies that do bonding, because that is the closest analog to protecting against -- insuring against bankruptcy.

We said to them, "Well, how do you set up a program to do this?" We were already set up, so it was a little late to start asking that question. They said, "Well, we don't insure out beyond five years." We really don't like to insure much beyond three years, only the most gold-plated credit gets bonds or what is the credit that is extended out there, except on a very, very, you know, heavily secured basis. So they said, "We would not take that risk." When I came back in 1993, somebody actually had created a type of insurance, and they had created it for non-qualified deferred compensation, executive, unfunded, executive insurance.

They had sold one policy, and they sold it to Arthur Levitt. The reason they sold it to Arthur Levitt, is because he couldn't become the head of the SEC, if he was at risk for the American Stock Exchange, which he had previously headed. Since he had an unfunded, deferred compensation arrangement with them that would pay him in the future he had to make sure that he was not at risk if the American Stock Exchange failed, because otherwise, obviously, that would affect how he regulated the American Stock Exchange. You can't really be the head of the SEC without being able to regulate the exchanges. And so, one of the big insurance companies had such a product that they had been thinking about and they actually got it approved to sell him this policy. They've had some luck in doing that.

Bargaining unit, they are only selling, so we talked to them, and we said, "Great, you guys have now figured out how to do this." They came in and said "We have an idea, we'd like to sell PBGC re-insurance to executives." They are facing a risk, because you know, you don't guarantee all the benefits, so we will take the part that you don't guarantee, we are going to only sell it to the highest credit quality companies, AA and AAA rated, and we are only going to sell it to them if their plans are fully insured. They told us what it was going to cost. And we said, why would anyone buy this insurance because those are not the plans and the companies that fail. They said that it would only go out, it would be renewable term, it would extend for two or three years, and then it would be renewable, but of course it would only be

renewable if at the end of the term your company was still AA or AAA rated and your plan was still fully funded.

It was a lovely idea in terms of the income of the insurance company, but it wasn't a productive product to sell. They decided, after talking to us and talking to some other people, about whether they would buy it, and they decided not to offer the product. We, in contrast, end up assuming the unfunded pension liabilities, of companies that go bankrupt so we are obligated to payout pension benefits over periods lasting up to 40 or 50 years. We can't require that the plans be fully funded, although there are rules that over 20 years, we have tightened up by going to Congress for additional legislation. We have no regulatory authority to go in and say, Hey, you don't have assets to back your liabilities," so that makes us unusual. We really have even less control over the employers, and how they run their businesses.

Banks are regulated, insurance companies are regulated. Our typical risks, over the life of the agency, have been primarily in cyclical industries, heavy rust belt kind of industries like steel, auto, and rubber. In fact, through the '80s, if you had asked us what are you doing one of the executive directors in the mid-'80s described us as a subsidy for the U. S. Steel industry, which led to accountability claims from the Mexican steel industry, which we luckily won.

The truth was, most of our claims, through the mid-'80s were large steel companies; the Wheeling Pittsburgh bankruptcy and the LTV bankruptcy. Through a series of legislative changes, we managed to change the mix of our exposure and in the beginning of the '90s, we started to take airlines. Steel, auto and rubber and the other cyclical industries are at least sort of predictive, a lot of people study these industries. You can't exactly tell how deep or how long various parts of the cycle are going to be, but you know that they are going to be cyclical, you know they are going to be up, you know they are going to be down.

You can sort of predict. There are lots of people who will tell you that back in '93, when I came here looking at the auto industry because that is where a lot of our losses were focused, and they could tell you that around '97 we were going to have a dip. Everybody sort of thought, back then, that the dip was going to be a little dip, but everybody recognized that that is what they thought in the early '80s, and the dip turned out to be a big and long dip. The Agency looked at it and said, we've got to do something about this.

We have lots of economic analysis about where is our exposure, and things like that but it doesn't tell you about what plans you are going to take. We started out thinking, okay, we will focus on the underfunded plans with companies that are a poor credit risk. Most of our large plans are maintained by public companies, so we don't have to provide our own data. CompuStat compiles the data from the financial statements, so we can learn about the funding of the plan from the footnotes of the financials of the company.

What we realized is that if you are only looking at the financially troubled companies, then you are going to be repeating what has happened through the history of

the Agency, which is, we are going to be there with the rest of the creditors with a company that doesn't have enough money to pay. We are all going to be fighting over cents on the dollar. So we stepped back and said, "Okay, let's look at our largest risk, just purely in terms of the underfunding in the plan."

Now, we know that is not a good predictor of whether we are going to have to take over the plan, but we know this is the group of plans from which will come the plans that we do have to take over, that represent those kind of uncontrollable big risks. There are a lot of little plans that we take over, we can afford those. It is these big hits that are causing us a lot of problems, and we move into these huge deficits. So we said, "Okay, let's look at every plan that is underfunded by more than 25 million dollars" and there wasn't anything particularly magic about 25 million dollars, it was a big number. The result was it generated about 200- 250 companies and that was a manageable group to start with.

It turns out we have tended to look at the top one percent of the plans that we insure, or the bottom one percent, depending on how you want to characterize them. Only about one percent of the companies who maintain plans, maintain these large underfunded plans. Those plans, represent 85 percent of our exposure. Focusing on those plans, and there are now about 400 of them, we have been able to identify plans that are the most probable of presenting a claim to us in the next five, ten, fifteen, twenty years.

Those that are in good credit shape, we are not going to follow as closely. Only if they are doing something that we think will put us at risk, will we look at them. They are in our inventory, someone is assigned to them, and we tend to assign our analysts by industry, rather than any other indicator. The airline person is looking at all of the airlines that have underfunded plans, but tends not to focus on those that are fairly high credit quality.

And the same thing in the steel industries, they spend less time on a company like USX than they do on a company like LTV. Those that are financially distressed, we keep a close eye on. We have very little control. I mean, if General Motors doesn't know how to produce automobiles, we can't go in there and tell them how to do it. We can't control their business plans, and we shouldn't. I mean, we don't know how to make cars. Although a couple of my guys, I think, do know how to make steel but we certainly don't know how to run other people's businesses, and we don't make any attempt to do that. But we keep an eye out so that we are not surprised when they go into bankruptcy, if it gets to that. We are also aware if they start restructuring their loans, or doing other things that put other creditors ahead of us, or making distributions to their shareholders, since in a bankruptcy, the equity holders, the share holders come behind us, we just as soon not have the cash going out the door to them, while the plans are underfunded.

When we look at the better funded companies, what we are looking for is to say, okay, they are not a credit risk, but are they going to do anything that presents us with a

credit risk? The typical situation that we -- where we have had losses in the past, were situations in which they had transferred a money losing business, and its underfunded pension plan, to a poorly financed buyer, the LBO's of the '80s are perfect examples. So we said, "What can we do about it?" Now, we have two choices when that situation occurs. The first is, that we can let the transaction happen, and then under our statute, if we can prove that a principal purpose of that transaction was to evade liability to us or the pension plan, and the plan fails within five years after that sale, then we can go back and bring suit under an evasion theory, against the buyer and the seller, and everybody who was in sight.

Well, we've only done that a couple of times in our history and in each case, it has been an extended litigation. We are now winding up a case that started with a sale in 1985, and we are due to go to trial in March. So that is not a very effective way to do [business] - and we ended up with the plan, so it is not a very effective way to deal with the problem. The other alternative, and the weapon we have had since the beginning of the agency, but one we had been reluctant to use, was that we could terminate the plan. Beginning about four years ago, we started to look seriously at these situations, to decide if we were better off to let this happen, let the transaction go forward and face the risk that it will terminate either outside the five-year window, or the plan will terminate inside the five-year window, but we will have to bring this extended evasion litigation, or are we better off to just terminate the plan now, at a point where we can get a full recovery?

And so we started to look at that and I mentioned that this group focuses on big underfunding. The very first case, however, was a very small plan. And this very small plan just happened to be in the same group with a bunch of other plans, some of which were big. We moved to terminate that plan when there was a transaction that would put us at risk, which is the statutory. We moved to terminate that plan, even though it was small, and got a very good precedent, legal precedent, saying that like other agencies' decisions, this was viewed -- this would be reviewed by the courts under the Administrative Procedures Act. Basically, as long as we had a basis for it, we would be successful.

Having that legal precedent behind us, we have been able to negotiate a number of settlements with companies. They, sometimes, characterize it as blackmail, because they don't want to tell their employees that the plans are barely funded. But we've been very creative. If there is one thing I would say to you, after you figure out what your risks are, is that you really need to think outside the box. You need to think about ways in which you can get the parties that you are dealing with, to find that it is in their interest to minimize your risks.

We've spent the last three or four years doing that. First publicizing the underfunding, and then negotiating creative solutions. And I don't think our particular solutions are terribly important for other people in terms of learning how to do it. But what is important is to begin to think about using whatever enforcement tools you have in new and in creative ways, and interacting with the population that you are insuring, thinking about ways in which you can interrelate, so that, as one CEO who put 385 million dollars in his plan last

year said, "funding up your plan is just good business."

MODERATOR STANTON: Thank you very much. Marsha Reidhill of the Federal Reserve System, they have a new system of off-site monitoring of examinations. I'd be also interested of when you changed your acronym from FIMS, but this is something really to look at.

MS. REIDHILL: Thank you, Tom. Like so many things in Washington, changing the name, the name is very important in how you present something, so that became kind of like a political thing. So to get an article published in the Federal Reserve Bulletin, in January of '95, we had to change the name, because SEER sounds like, oh we are forecasting, we are -- you know, we are forecasting correctly. With the kind of metric models, what I found is that you can, on average, you do a really good job, but for any individual institution, boy you can be a long way off. So we don't want to oversell the model.

Can everyone hear me pretty well? Like the other agencies, one of the things that we are interested in at the Federal Reserve is monitoring risk, and trying to identify deteriorating institutions. We want to catch them before it becomes a problem and causes losses to the FDIC insurance fund. Previously the Federal Reserve used a system -- there are a lot of different things out there, and a lot of agencies use similar type systems. You have expert systems, which I give a lot of credence to.

When you get a lot of your experts in a room, and you say, what do you look at to assign a rating, or to assess risk in an institution, and they say, well, we look at asset quality, we look at liquidity. If you kind of build an expert model, it is going to do a pretty good job in capturing your distressed companies. The Fed had previously used a system where we took, you know, asset quality, earnings, capital, liquidity, and we ranked all 10,000 banks at the time, and then we would add a cross, who is in the worst of all this. Then when we would come to the end using our ranking system, we would always take the worst 15 percentile in this distribution, so it had a cumulative ranking. Well, that is kind of a good thing to do, and you can capture quite a few institutions that way, but unfortunately you capture 15 percent all the time.

You know, when the industry is healthy, like now we are having record capital, record profits, the industry is healthy. Well, we probably don't need to be analyzing 15 percent of the industry every quarter. When the industry is really bad, like it was in '89 and '90, we probably need to be looking at more than 15 percent. So the Fed began work in 1989, 1990, not in developing an expert system, because we've used those from other agencies. Instead we developed a very statistically rigorous -- we drew up a couple of CAMEL rating models to help us analyze our banking institutions.

It is currently called SEER, that is what we use internally for public purposes, as it said in the Federal Reserve Bulletin, it was called FIMS, Financial Institution Monitoring System. Basically, our goal is to identify deteriorating institutions, deteriorating banks, in between our on-site examinations. As background, there are 10,000 banks the Federal Reserve is responsible for; 1,000 state member banks, the FDIC has around 6,000 banks, the Comptroller of the Currency has around 2,500 to 3,000 banks. Pretty much every year to a year and a half we send examiners on-site to our institutions. If it is a very well rated bank, we may only go in every three years, because we alternate with the state banking agencies.

Well, as you are probably familiar with, through the papers, a lot can happen, in a year or two years. An institution can go south, can deteriorate very, very quickly. So, obviously, we can't wait just for these every year and a half to three year on-site examinations. Our goal is to use SEER to monitor the condition, and try to identify deteriorating institutions in between these on-site exams. It helps us, we use -- as Art was saying, call reports, financial performance reports, balance sheets, income statements, off-balance sheets, activity items, and non-performing asset information. We collect this kind of information on all 10,000 banks every quarter and this is the information that we use in our model.

Our overall bank program, and we have a parallel program also for bank holding companies like Citicorp, is the holding company. Underneath Citicorp you have Citibank, you have Citibank mortgage, Citibank thrifts, Federal Savings Bank. For our whole bank program, we have our SEER models generate two different ratings, or numerics that we use and work with. As we identify an outlier institution, we say, gee, this one seems to have a little more risk. It is different than the rest of our healthy institutions. We want to follow up on this institution. So what we do, we run all this stuff here at the Board, in Washington, we identify the outlier institutions, and then we send them out to the reserve banks, and we have 12 Federal Reserve Banks, and then the reserve banks will follow-up and prepare a detailed written analysis of the banks that we've identified on what we call our exception list, generated by our SEER models.

Reserve banks prepare written analyses where they assess the financial factors that place the bank on the exception list and recommend corrective supervisory action, if that is required. We've entered into written agreements because of some of the institutions that we've identified. The reserve banks have an officer in charge of supervision, so we really elevate the level of attention that we like to have placed on these institutions. Officers in charge of supervision sign off on the analyses that comes back to Washington, and then we have another set of analysts here in D.C. that review the reserve bank analysis to determine, whether the reserve banks do an adequate job of assessing the factors.

As I said, we have two SEER models here that we run. The first one is an examination estimation model. That is where they are both econometric models, they are regressions. We try to explain it as if you assigned an examination rating, today, based on the most recent two quarters of financial reports, what would it be? We can't take into account things like

internal control problems, insider lending, fraud, things like that. We can't get at that from an off-site perspective, you've really got to be at the bank to do that.

So we take the most recent call report data, which are our financial statements, run it through our regression, and then we estimate a CAMEL rating. The second model we run, is to estimate the probability of a bank failing. I'm a bureaucrat, I don't say this bank is going to fail, I say, this bank actually exhibits characteristics of banks that have previously failed. Tom was asking, "Well, how do we convey this to our examination staff?" It is a black box. And if I say, there is an 80 percent probability this bank is going to fail, or there is a 90 percent probability, and then it doesn't fail in the next two years.

Frankly, I kind of look at the industry now, I can't believe many banks are going to fail in the next year. The banking industry is doing very well, so we will lose a lot of credibility. Instead, I say, and this is econometrically correct, I say, "Well, this bank has a 90 percent chance of failing, if we repeated the same economic conditions that existed over the time period we were running the model." So it is kind of a little bureaucratese, but it is also correct. And it helps explain, even though it is not going to fail in the next year, it certainly displays outlier characteristics, so we want to follow up on this institution.

There are a lot of failed bank models out there. The FDIC has used, I guess, a similar type failed bank model and their failure loss estimates for the insurance fund. At the Fed, we have a slightly different approach. We are not looking at how much is the loss going to be if a bank fails? We want to get in there and try to take supervisory corrective action before it, in fact, does fail. In our failed bank model, this has also been kind of difficult administering this, because we run it every single quarter, we validate it. One of the problems we've had is the industry is so healthy, we haven't had many failed banks. We've had, you know, four this year. We had seven last year.

Well, you can't run a good model when you have 10,000 healthy banks, and ten that fail. Your model doesn't run. So we've had to go back and actually use a pooled model, where we take failed bank data from 1985 through 1995. Basically I've already described the estimation process. We take the most recent call report data, run it through our regression, we come out with the coefficients that give us the best estimate, the best forecasts for the rating, or for the failed bank.

The second bullet here says, estimate best weights. This is analogous to the expert system. For instance, when we run our econometric model, we have several asset quality variables in there, and there will be some coefficient, or some weight assigned to that. Our weights are statistically determined. In an expert system, examiners might say, well, I weigh asset quality, 40 percent. Well, our coefficient might be 35 percent. Overall we find that -- and we use the expert systems also, because they are very useful, you find the same variables over and over again. We use an expert system or econometric model, you see the same things. Capital, it is a lagging indicator, but you know it is there. Net income, you lose money, you've got a higher chance of failing.



Then you start hitting the asset quality variables. Even though there are a lot of hot issues out there in the industry now, no banks have failed because of structure net appreciation, or no banks have failed for interest rate risk. That is not going to show up in an expert system, or an econometric model, but that doesn't mean we shouldn't be looking at it. Basically what you will see is by and large, asset quality, liquidity earnings, that is what is driving all of our models. If we say the most recent on-site CAMEL rating was a one, our estimated SEER rating, which is estimated -- our forecast of CAMEL rating is more than a three; if it is a three or a four or a five, you know, you are tagged. We want to know what is happening in this institution.

Or if the SEER risk rank, and this is basically the probability of failure, if the SEER risk rank is greater than two percent, which actually sounds kind of low, until you look at the distribution and you realize that of 10,000 banks, 9,990 are less than two, so if you have greater than a two percent chance of failure, you are really an outlier. We've had a lot of success with our models. In 1995 we correctly identified 80 percent -- for our failed bank model we correctly identified 17 of the last 19 failures, for a success rate of 91 percent.

So we are very pleased with these models, and they provide a very good grounding, and it is the core of our bank holding company programs. That being said, we also have to look at other issues, like structure net appreciation. We still have all these -- they are monitoring screens that we look at on the side. We still have to monitor interest rate risk, we still have to look at structure net appreciation.

We look at banks and big holding companies that write options because there is presumably more exposure in doing something like that. Outside of the econometric modeling, we still have to monitor these other things, in a more common sense approach, pull in the expert system. We also use other Agency's models. FDIC has an expert model called CAEL, we use that. My management says, "she just downgraded this institution, what did you guys say about it?" I want to go, "we caught it." And without catching all 10,000 banks every quarter, you know, that is definitely how you identify everything, that is too much.

So we are much more selective than that. If the FDIC has other efforts on-going, we are very interested on those. We have other efforts on-going, so we just want to keep looking at this stuff.

MODERATOR STANTON: Thank you very Marsha. I'd like to ask you a quick question, and then throw it open. I guess one of the real lessons we hear, first of all, from each one of the presentations, is that one can design a quantitative system, and it is very valuable. But in addition you've got to supplement it with what Marsha called common sense. And some of your qualitative judgments which Ken, again, talked about, and Nell and George, I think, incorporates that implicitly in what he does.

I'd like to put on the hat of an appropriations subcommittee for a federal credit agency, and they are always asking dollars and cents.

I'd like to ask if each of the speakers might talk, briefly, about the question of costs and benefits. It comes up, for example, with Marsha's presentation, that we've got a whole bunch of very healthy banks. So if I'm an appropriations person, I say, hey, why bother, guys? You know, they are all healthy, why have early warning?

So if I could ask each of you, very briefly, just to touch on this question of how much does it cost you to do something like this compared to what you think you get for it?

MS. REIDHILL: Well, I can say that running these models is an incredibly efficient use. You know, we are under budget constraints, but sending examiners on-site is very expensive, both in terms of budget money travel, you know, reimbursements, things like that, and human resources, time on the job. So when you don't have a lot of problems, you still need to go on-site, because things can deteriorate. But running these kinds of models, I mean, processing 2,000 items for each institution out of 10,000 institutions is an incredible efficient use of time and resources.

I expect, because of potential budgetary constraints, that we will make even more use of this, specially as the industry continues to be healthy. But we really have to be watching this, and not be too tight with our on-site resources.

MR. FRENCH: As far as costs are concerned, the Division of Insurance, we have 33 people in the division. The Federal Deposit Insurance Corporation has approximately 9,000 employees right now, coming down from 22,000 five years ago. So we are a sort of a drop in the bucket, relative to the organization.

The benefits, if we somehow alert people to a risk in the system that prevents the failure of a couple of small banks, or one medium sized bank somewhere down the road, I think we've earned -- we've paid for ourselves.

MODERATOR STANTON: Ken?

MR. GOULD: From the Home Loan Bank, I mentioned we have costs of five basis points. There is no room for a single credit loss in our business. In addition to that, just an operational cost standpoint, we run -- in our particular bank, we had 90 billion dollars worth of loans outstanding.

The staff in the credit department is six. This model was developed entirely within the credit department with the assistance -- I run systems as well as running credit. In the systems area, it costs me about eight hours a quarter to download this information. So does it have value relative to the cost of preparing it? I think it has a ton of value.

Last Friday we ran a little special on loans, we made 79 credit decisions, in a four hour period. You can't do that without some sort of automated, efficient, reliable

screening factor that allows you to give good customer service. These are all, by the way, same day, and it was in the neighborhood of 300 million dollars worth of credit that was extended that afternoon, using this model, with six people.

MS. HENNESSEY: We don't use an expert system, because since as I mentioned, our risk is the failure of the companies, we use the experts -- we essentially are using the expert systems of the S & P Moody's, and negotiated with the other rating agencies to screen for credit risk. We've got, in terms of our negotiations with those companies that we actively deal with, in a given year we probably interact with fewer than 30 companies. Sometimes more than once, but the same companies. We've got about 15 people who do that but they are backed by a research department that has the capability to extract from all the public data, all the information that we get from the companies' financials, and to enable us to winnow it down to the 400 that we look at.

MODERATOR STANTON: Although, if I can add something from your Kennedy School Award, it is my understanding that the fact that you could take early intervention, in fact, has saved a considerable amount of money compared to probably the overall budget of the pension --

MS. HENNESSEY: Absolutely, because -- I mean, our biggest risk was GM -- where they put 10 billion dollars into their plan. But last year we did about a billion dollars in settlements and as everybody who deals with me knows, I always prefer cash, although we are willing to take other things.

MODERATOR STANTON: All right. All I can say is for people from the federal credit agencies in the audience, this is the future. Any other questions on that note? Yes, please.

PARTICIPANT: Comment with how does that termination effect the employees?

MS. HENNESSEY: Typically what happens, we guarantee benefits up to about 32,000 dollars a year, annual pension benefits. There are a variety of benefits that we don't cover, like early retirement, certain early retirement benefits. In every plan that we take over, if the plan, when it fails is underfunded, I mean, when it terminates it is underfunded, we take it over. We take the bulk of the liability, probably 90 to 95 percent of the benefits are fully protected.

There are about 5 percent that are not. In the steel industry, in particular, we've taken a lot of claims. It is the people who retired early who have the biggest loss, because they have a social security supplement, designed to bridge between when they typically retire at age 55, and when they can begin collecting social security at 62. So there is a

little bit of co-insurance, but it is not a significant factor.

PARTICIPANT: I have a second question. Are you responsible for the whole retirement package, or just the financial part of it? In the news last week there was a study where they terminated all medical benefits.

MS. HENNESSEY: We only insure the pension part of it, we don't insure the medical. In fact, in the health reform debate, one of my assistants was detailed up to the Hill, and her instructions, from me were to work on pension legislation, but her instructions also were, if you hear any hint that they are going to have us insure health plans, just alert us. Just remember the mantra, PBGC does not do health.

MODERATOR KESTERMAN: It is a political early warning system.

PARTICIPANT: -- the big thing with all this insurance -- because it is centralized, the Federal Government should be able to do a lot of the forms. You have seen the problems created for institutions. You have seen the Office of the Comptroller of the Currency data for institutions that have had a problem with equity.

MS. HENNESSEY: We tried to get that enforcement power, it was interesting. Because we tried it -- we got new legislation in the first two years of this administration. In fact, it was on the GATT, so it passed in December. Between the election and the vote on GATT, our own examiner said to us, what is on your legislative agenda for next year? And I said, nothing.

If this passes, we are not going back for any of the stuff we didn't get. The one thing that we got incredible resistance from, was giving us new enforcement powers. So much so, that the business round table threatened to tank GATT, and the administration ultimately pulled that part of it out. Basically, what they said to us, literally, in a meeting with big business, they said, you know, we think you are doing just fine with the tools you have. So we have taken them at their word, and we predicted that, in fact, they would be sorry, because we have only the atom bomb, but we are prepared to use it, if we have to.

PARTICIPANT: And then there is another question.

MS. HENNESSEY: But, actually, can I tell you one thing that we did do that was really interesting? This is an example of thinking outside the box. We got some reporting, additional reporting, and we have managed to trade the additional reporting, we did a negotiated agreement -- and we have managed to trade the additional reporting, giving exemptions from the reporting, for an agreement from the private sector, that they would in fact report on things that were more troubling to us, that we hadn't got explicit legislation to get reporting on. I mean, we had authority to mandate additional events. And so that is a way to do it. We also get people to agree to report to us things in exchange for us waiving their reporting

on other things.

PARTICIPANT: This is the question concerning our right, I mean, what was first testified in -- prior to 1989 and how did it come about. What has to happen in your relations to certain series being done on the capitol ratios -- being done on book values that pretty much allow you to make up whatever you want. You immediately have systems for gameables like -- do you see market value of county coming in and what has to be done to that value?

MR. GOULD: We see market value accounting coming in. It has been talked about for the last 10 or 15 years, it is difficult to do. The problem is that we all have these wonderful models that we use to do our swaps and our caps and our match-offs, and then the accountants come by, and they want to say, "Well okay, fine, I'll use this mark to mark it on this segment of your balance sheet but on the other hand, don't use it on the next segment." And so what we have to do, eventually, is get to the point where we all go mark to market, and reveal what it is we are doing. Then you have to figure out how to measure this thing, and that will make it nice.

MS. HENNESSEY: But one of the things you also have to recognize is that access -- we do typically do -- we do get reporting on market value assets in the pension plan, but what we've realized, and I think all the banking types would agree with me, is that probably the critical element in terms of whether an entity can survive or not, is cash flow. One of the interesting things was, there was a discussion at Financial Accounting Standards Board about whether to change the pension accounting, because right now the way in which the expense is booked is an accrual basis, not a cash basis.

There were a lot of the economists debating, and when they talked to somebody from Wall Street, he said "Basically yes, we start with your accrual numbers, but we are making a whole bunch of adjustments trying to figure out what is the cash impact." The difference between companies failing and surviving, is can they afford to pay their bills? We don't have good accounting, cash accounting.

MR. GOULD: It is better than it was, but it is not good yet.

MR. FRENCH: The primary reason that banks have failed, as we all know, is credit risks, losses on the loan portfolio. The reason that we have a banking system and deposit insurance is precisely because loans are not traded in markets, there is limited information about borrowers, sort of idiosyncratic, and so forth.

So the question is, how do you have a mark to market system for loans? I mean, I think about the closest you can get is sort of a good loan loss reserve allowance, which is sort of monitored by examiners on an on-site basis. Apart from that, I don't know, maybe you have some suggestions, but how would you institute a mark to market system for the loan portfolio?

MS. HENNESSEY: That assumes an efficient market.

MODERATOR STANTON: As a moderator, I'd love to get into market value accounting. I've been there, at one point, with respect to certain proposals. But Frank has another question, and maybe you guys can continue later.

MODERATOR KESTERMAN: I have actually, for two or three people. But let's stay with collateral value. Ken, you said that once you have an institution on the watch list, the five percent list, you get monthly reports on collateral.

Most of your collateral is mortgages, is that correct?

MR. GOULD: Yes.

MODERATOR KESTERMAN: Do you mark that to value, what are these --

MR. GOULD: The primary piece of information that we try and get on these collateral reports, is it encumbered in any other way? As mortgages become increasingly understandable by various segments of the market, others have sort of come into our marketplace.

We used to be the exclusive lender on mortgages, now we are not. We find our customers having lots of creative deals. So the first question we ask them is, have you encumbered your mortgages? The contract with us says they will not, and we would have rights to sue them if they did that. Unfortunately, if those assets are encumbered, we don't have the right to get our hands on them, and that is really what we want.

Second thing that we are looking for in these monthly reports, if there are delinquency changes in the behavior of those mortgages? The third thing we look for is whether or not the value of the mortgages is changing. Are they -- let's say that they have mortgages that would support three times their credit, and they start selling some.

Even though it doesn't impinge on the amount of collateral that is available for current credit, it indicates a change in their business strategy, and we want to know about that the month it occurs, or the first of the month thereafter. So that is -- the reporting is a very simple one-page document that talks -- it mentions the earnings and a few other things that we also become interested in, at that point. But it is all one page, and we have about 50 folks that report on it, because it is not just shortage of the collateral, it is if you are close to your limits on credit, if you've ever had encumbered mortgages in the past, if you've got less than 10 percent

mortgages on your balance sheet, for a variety of different reasons.

We have about 50 folks who make that report every month, and they do it gladly. We have one guy who wanted to do it with a different format, and not a problem.

MODERATOR STANTON: Let me ask you a question. Let's assume that Charles Keating is head of one of your borrowers, just to use a random example.

How do you validate quality of information, if somebody is on the watch list, that is when they are under pressure. Why are they going to give you especially accurate and timely reports at that point?

MR. GOULD: Because I'm not going to give them credit, if they don't.

MODERATOR STANTON: But how do you validate the quality of what they are sending you?

MR. GOULD: We ask their external auditors, at least once a year, to verify the collateral, to go in and do a random sample of the mortgages, look at them from a variety of characteristics, which we specify.

And we then want those auditors to give us a report that tells us -- but we have the external auditors come in and check them out on an annual basis. If it was Charles Keating that was giving me a tough time, I'd do two things. I'd say, fine, you want credit with me, put all of your collateral in a special room, I'll have a guard over it --

MODERATOR STANTON: But we don't know he is Charles Keating until after the fact.

MS. REIDHILL: Isn't your question, whether there is fraud?

MODERATOR STANTON: Yes, basically, that is the hardest thing to deal with. If there is somebody under pressure, they may exhibit new behaviors from before, I'm thinking of mortgage companies where Ginnie Mae may have something on the hook, and you may have somebody who really wanted to make it go, and all of a sudden they are in trouble. And the question, at that point, isn't your information of questionable quality?

MR. GOULD: Actually, I don't want to be too cocky. Obviously you can have problems. I'm thinking of a variance situation that was completely out of the blue. I'm thinking of any number of other situations over the past 10 years, large commercial banking situations where it really was hard. But in most of these cases, if you are paying attention, almost all of these cases that are "surprising" in newspapers, if you are looking at this data closely, you see the signs. You see that something is different about that firm. They start to build their assets, they start to decrease their capital ratios. They start to do business in a different area, different

items on their balance sheet begin to pop up, and you say, "Wait a minute, they've not done this before," and you start the dialogue.

Once you start the dialogue, and you start asking the pointed questions, because the chief financial officer has personal liability if he does not say the truth, you will find behavior patterns, speech patterns that I can't tell you exactly what they are, they vary by person. But after you've listened to 10 or 15 of the conversations, you can recognize them pretty quickly. That is when your people have to go out and start talking, and you have to not be embarrassed to say, give me the collateral now, long before the individual has a problem.

They say, well, "I'm healthy, you know I'm healthy." I say "Yes, and you bought stock with the Home Loan Bank, and I'm protecting the value of your stock, and this is what I do with everyone. Now, please give me this collateral now."

Sometimes those are tenser discussions than you would like, but they always have to take place early, because you cannot stand the kind of loss that comes with a Keating and Keating was known.

MS. HENNESSEY: And one of the things that I think that is funny, because when you talk to a lot of the former Soviet Union countries that are setting up pension systems, and so we've talked to a number of them. In trying to think of that, we so take for granted our system of auditing. But when you step back and you look at a country that doesn't have the kind of rules about banking and securities and all sorts of things that have been imbedded in this country for more than 50 years, it makes you realize that we have a very complex system of checks and balances that works.

The linchpin in the financial area is the auditors, both the internal and the external auditors, because there is going to be no federal agency, there is going to be no regulatory agency, there is going to be no sort of watchdog credit agency that is going to be able to look and see whether the steel they said they produced is on the lot, or going out the door.

MODERATOR STANTON: Marsha, did you have any comments on the quality of information?

MS. REIDHILL: That is something else that, you know, I was mentioning, you kind of see these outliers, and these are the things that we look for, and a lot of times, when we see a blip in an institution, it can be a data error. Let me follow up. We have very extensive edit processes for the financial data that comes in, because, you know, if you have crappy data coming in, you certainly have crappy analysis coming out.

The quality of data is very important, and that is also that an on-site examiners review about the institution. There is a lot of compliance in confirming the financial reports that are filed are correct, so that is very important.



MR. GOULD: It is surprising how much warning you can get in most situations, I exempt the Berrings.

MS. HENNESSEY: And I think Tom identified the reason for that. The people that you have to worry about are the people who are stressed in some way, financially, or are under pressure to produce business. I think that is the Berrings situation, and so if you can identify something that is a change, either a decrease in financial position, or some other stress, deregulation in some of the industries, for example, the airlines.

MS. REIDHILL: We always look at new activities. Who is new and --

MS. HENNESSEY: And because those are the points in which people, either for their own income, or the company's benefit or whatever, tend to slice things a little more finely, they get a little closer to the line, and every time you try to get them to stay right on the line, somebody goes over.

MR. GOULD: We look for earnings that are unusually favorable, because when you see those, you have to ask the question, what does this customer know that some other customer doesn't know? Frequently they know less. They are reporting something that looks like a profit today, but is sure to be a loss tomorrow.

MS. HENNESSEY: As a lot of people learned on derivatives. If it looks too good to be true, well --

MODERATOR STANTON: Frank?

MODERATOR KESTERMAN: Maybe, it is an outside chance, but maybe Ted Foster's issuers are some of your members. And the delinquency data might be of value. Just an idea. I have a question for George. You mentioned risk based premiums, but there is a lot that goes with that. And I thought maybe you could expand just a little bit about that, the known categories and how that came about, and so forth.

MR. FRENCH: That is a whole other area, as you say. But that was put into place as a result of the banking act of 1991, Federal Deposit Insurance Corporation Improvement Act, otherwise known as the FDICIA.

You were required to put in a system of risk-based deposit insurance premiums for the first time in our history. Previously we had always charged premiums at a flat rate, about 8 cents per 100 dollars of deposits. Now we are varying the premium based on the risk of the bank. We have sort of a matrix approach, a three by three table. There are three rows corresponding to capital levels, so-called well capitalized institutions are at the top.

Adequately capitalized is the middle row, and then there is undercapitalized, which is based on statutory criteria, if your equity goes below, essentially equity

below four percent is the lowest category. The three columns are corresponding to our CAMEL rating system, which is the on-site examination, which is done approximately every one to two years, by all of the federal agencies, the Federal Reserve Bank, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision.

There is a one to five rating system, where one is the best, and five is the worst, so the rating, one or two, is the best component, the three rating is the middle column of the matrix, and then the four and fives, which we call the problem banks, are the last row. So your best institutions, and oddly enough, of the 10,000 banks, the FDIC insures, 95 percent of them are in the "1A" or best category, and pay basically zero for their deposit insurance. This kind of reflects some statutory situations that the FDIC is in. There is a requirement that the insurance fund can't go above 1.25 percent of the total insured deposits. Essentially that is the requirement.

So we are in a position where we basically have to charge little or no deposit insurance premiums for most of our institutions. So the remaining two or three percent of the institutions are in the remaining eight categories. The rates for insurance range from, as I said, basically zero to 27 basis points. And, actually, just in the last two days, the bank insurance fund, and the savings insurance fund legislation was signed by the President as part of the spending bill that recapitalizes the savings association insurance fund, requiring a contribution from the savings and loan industry, or the thrift industry. That fund is now re-capitalized as of yesterday. And now the savings and loans and the thrifts are now paying at the same rates as the banks. So that is where we are.

MODERATOR STANTON: Unless there are other burning questions, we have run a little over. Again, I emphasize, this is the future, and panelists, you have made a real contribution, and I think we will see that as federal credit programs move forward. So thank you very much.

We are running late, and in order to coincide with our television time, I recommend we come back here -- we take a good substantial break now and start the next session a little bit late.

Thank you.

(Whereupon, the foregoing matter went off the record at 10:35 a.m. and went back on the record at 11:07 a.m.)

MODERATOR STANTON: Hello, welcome to the second session, this morning, of the credit practices workshop. This session will stress a theme that John Koskinen raised yesterday, which is service to customers. The ultimate borrowers who receive

the loans that the Federal Government makes.

We are going to have a variety of promising practices we want to highlight here. One from the Small Business Administration involving borrower access to loan information. There is something called Intervoice. One from the Veteran's Administration, with respect to special servicing of borrowers whose loans may become troubled, but who can be placed back on track. This picks up a theme we heard from Freddie Mac, yesterday, that we are appropriately targeting. Borrower counseling can do a lot of good for people, and help the government, basically, with its mission, which is very often to make loans that aren't being made in the commercial sector.

We have a representative from the, Department of Housing and Urban Development (HUD), talking about expedited refunds to home owners of their mortgage insurance premiums, for example, when they refinance their house or sell. We will have another speaker from HUD, talking about how we can understand better what each agency does in terms of customer service. I hope you've seen the display outside, sort of an awesome geographic mapping of all of the different HUD programs that apply to a locality.

Again, the whole theme of this workshop is, for people from one agency to pick up on others. You can imagine the Small Business Administration) or the Department of Veterans Affairs (Department of Veterans Affairs (VA)) or others wanting to learn this, and figure out how they can demonstrate the benefits of their services to individual localities. And not to put too fine a point on it, congressional districts.

We will, at that point, then close with a representative from the General Services Administration (GSA), talking about government-owned real estate, and the actual selling of assets into private hands to private individual customers. And this is a very good time to say thank you very much to our friends at GSA, who have given us both the space and are facilitating TV broadcast.

Now, what is going to happen is, someplace in the middle of our program, we are going to go live to television land, and I will, at that point, have to say a couple of words to explain to the TV audience what is going on, and to catch us up. What we found out was we had an overlay of available TV broadcast time and our schedules. So you will have to bear with us as we juggle between two worlds, so to speak.

For our first speaker today is Gail Beynon, of the Small Business Administration (SBA). And SBA, really, and I think you've heard this tone over and over again in the SBA presentations, is very sensitive to their borrowers, to their customers, and really wants to serve their businesses in a business-like way, and really does look at those businesses as customers.

So, Gail, we are delighted to welcome you to talk about Intervoice. And if you want to come up here, that is probably the best.

MS. BEYNON: Hi. Now, in SBA, the other speakers that you have been hearing are basically from the program areas offices. I'm from the data information office. Office of Information Resources Management is the grand title.

What my responsibility at SBA is, is to oversee all of the portfolio management automated systems that we have. And this Intervoice System that we have now, up and running, is just one among many. But the interactive voice response benefits both us and our borrowers. The SBA's IVR answers every call on the first ring, never puts a caller on hold, provides accurate information immediately, increases employee productivity and retention, and controls staffing costs.

Now, these are the goals of every government agency, and most businesses that want to charge ahead in the '90s. So interactive voice response systems are a practical means of reaching the goals. Through integrated voice response, callers can access specified information quickly and easily by pressing buttons on their touch tone telephones.

The benefits are many. With interactive voice response, calls are answered all day, every day, without an operator, or without placing your customers on hold. Callers receive accurate and reliable answers to questions, and service staff are free to work on other important tasks that require their special expertise.

Voice response provides more service to more customers, without additional staff. It improves customer and employee retention, through increased satisfaction and it gives a quick return on investment. More savings, increased service, and greater productivity is what it is all about. Voice response improves the public's conception in many ways. With thousands of these systems installed world-wide, this technology is helping large and small government agencies and companies provide better information services in a variety of applications.

Some examples are insurance. They cover verification claim reporting, utilities, outage reporting and account increases. Financial institutions, account balances, cleared checks. In human resources you've got benefits, employee verification. In education you've got course registration, grade reporting, transcripts. In cable TV you've got pay-per-view, account status, service. Help desks, it is great for help desks, for routine inquiries and technical support. Health care, test results, physician networks. I mean, there is a myriad of possibilities here. The breadth and scope of voice response solutions are limited only by our imagination, and, of course, the quality of the supplier. The quality of your voice response supplier is vital to the make-up and life span of the system. You need to choose a company that has a proven ability to deliver high quality, state of the art solutions. What I've termed as the robot operator, interactive voice response system, is the reason why. Just think of all the businesses that you deal with, today. Your bank, your mortgage company, mutual funds, stock companies, credit cards.

They all use this technology. You can call, you get your balance information, payment information, pay-off figures, interest rates, and so on and so forth. You can also direct when payments are debited from your bank account on a demand basis and change the amount, as well. SBA has a combined the interactive voice response system (IVR), with our pre-authorized debit system. Now our borrowers can get information about their loan, they can have it faxed to them, and authorize us to debit their bank accounts whenever they want to.

SBA's IVR system allows the SBA borrower a selection of english or spanish languages, access to loan payment balance information, and authorization of loan payments through the pre-authorized debit system from their checking accounts. Borrowers can change the amount of a pre-authorized debit loan payment, request a fax via the United States Postal Service of account information, and change their pin numbers. Satisfied customers are the norm with an IVR system.

MODERATOR STANTON: I need to break in. The lights going on means that we have now gone to television to both the Federal offices around the United States, and world-wide through satellite down-link.

We welcome our national and international audience. We are currently doing a session of the federal best practices workshop on customer service, and are hearing from Gail Beynon of the Small Business Administration, which is an agency that has done especially well at treating its borrowers like customers to whom it is responsive. Sorry for the interruption, go ahead.

MS. BEYNON: No problem. When you are looking for a provider for intervoice, you've got to make sure you find a company who will take a consultive approach to your system design that incorporates the unique personality of your organization into a system that answers your needs, exactly, now and for years to come.

This approach enables voice response solutions in a broad range of industries, languages, and cultures. By listening and understanding your requirements, the company adapts the robot operator to match the way your organization does business. A handy service to have is a company whose technicians use an on-line remote diagnostic tool, so they can dial into your IVR system and solve most problems remotely, and immediately, which is the key point.

Training, you need to get benefit from the IVR system, your provider should offer a thorough training program. Training should range from one day to one week on all aspects of the system. Training aides should include videos, and complete documentation. The provider should work with you to adapt the robot operator to your specific applications.

Professional services can range from manuscripting, through helping you market the robot operator service. Now, some companies, like the one that we chose which is named "Intervoice," hence the title in the program, they have standard voice response packages to cover a majority of applications required for specific markets.

They can be installed quickly, and provide an ideal solution for smaller installations, where time and cost are at a premium. You will need to look for an industry standard computer system offering increased processing, memory and mass storage capabilities for now and the future. An operating system offering network control and data base connectivity, while providing multi-processing capabilities for mission critical applications that easily integrate a broad range of voice response features, and functionality, to meet your needs.

You need a robot operator system capable of both digital and analog communication systems that can be customized to the standards and specifications of your group. Today's open systems architecture provides multiple host connectivity and facilitate system upgrades. It offers a wide range of port capacity. From very small systems, for just a few ports, to systems requiring thousands of ports, integrated into one solution.

The wide range of features available should, when you are looking for a company, include speech recognition message recording, and graphical voice editing, text to speech script generation, fax capabilities, multiple host interfaces, connection to data terminals, TDD's, TDY's, modems, ASCII display phones, and so on.

You need error management control and you need central site control of remote robot operator systems. These types of available features will provide the solutions, the services and the support required to take care of your voice automation requirements today and in the future. In our experience at SBA, we installed our pilot system in July 1996 in the Birmingham, Alabama area, where SBA has a debt collection center. The center has a 40,000 plus loan portfolio. We mailed our borrowers a letter telling them how to use the system, and gave them their pin number. In the first week we had 8,000 calls, and eight borrowers changed their pins. Some of these calls were definitely from curiosity. However, as our borrowers got used to getting their loan information at a moment's notice, anytime, day or night, the calls to the collection center diminished considerably.

The system is averaging, now, about 3,000 calls a day in this one area. The call volume at the center has dropped by about one-third. Our other offices are clamoring to be next on the system. We are developing the schedule now to gradually phase them all in. And, needless to say, we like it. Now, the other thing we have at SBA, is our pre-authorized debit system. What we are doing when we mail out the letters with the information about the IVR system and giving borrowers their pin numbers, we are also including an application for the pre-authorized debit system, if they are not already in the system. This eliminates calls to our center asking them to send out the form. I think that is it.

MODERATOR STANTON: Thank you very much, Gail. If I may be

presumptuous, I would like to offer you the fact that Gail is at SBA, and those of you who are thinking of getting interactive voice systems for your customer base, may I say could call you up and get further information? What we have found, Frank Kesterman is the co-host here, for those who -- in television land who haven't seen Frank, what Frank and I found as we went around the Federal Government was an unbelievable amount of ferment.

I must confess that when I first heard the rhetoric about saving money and providing better service, I didn't believe it for a minute. But that is a theme in Gail's presentation, and that is a theme in our next presentation, Ann Baird-Bridges of the Federal Housing Administration Single Family Program, and expedited homeowner refunds. What we are finding is, all over the Federal Government, people are looking around and are asking questions of how can we do more for our customers, even in an age of less resources. Ann, welcome to the podium.

MS. BAIRD-BRIDGES: Good morning. What I'd like to share with you this morning, is how HUD has used information technology to turn a paper and staff intensive process that took over 120 days to get a refund check to a homeowner, into an efficient, almost paperless process, that gets a refund check to 78 percent of the homeowners due refunds, within five to seven days. This was done with an outlay of only 86,000 dollars for the hardware. Each year, a number of homeowners with FHA insured loans either sell or refinance their loans. Under the current regulations, if this occurs within the first seven years, they may be eligible for a refund.

The refund process is triggered by a notice of termination of insurance from the mortgage company. I wanted to share with you, first, a little bit about our old process, to show you where we have come from. The old process has approximately five major steps in order to get the refund. The termination notice is received from the mortgage company, and then when we receive those termination notices, HUD would send an application for refund to the homeowner.

The homeowner, then, had to return the signed form, and documentation, showing that they actually owned the property at the time of the termination. When HUD received the documents back in its office, we had to review them, we microfilmed them, the data was entered into our disbursement system. Every form that came in, and all of the supporting documentation, was reviewed by a HUD staff person. And then once they finished that process, the payment was certified, and we sent the tapes to Treasury, so that Treasury could finally issue a check to the homeowners. As you might imagine, going through these processes, this was kind of a time consuming process because every refund application had to be reviewed. This was done, even when we knew that all of the data in our systems agreed with the data that was submitted by the homeowners. We were, in essence, asking the homeowner to tell us what we already knew, and requiring them to send us documentation of it.

This intensive review created backlogs. At one point our volume was as high as 86,000. As you might imagine, our congressional inquiries and homeowner inquiries were

high at that point too. Prior to 1992, it was taking us over 120 days to process an application. The time has dropped, in October of '94 it was down to 90 days, in April of '96 it was 21 days, and now we are doing those streamlined ones in less than 10 days. Our challenge was to eliminate the requirement for the information that we already had. As a result, we did a system modification to automate a portion of the process to reduce processing time. Getting to this reduced processing time wasn't an overnight process. We phased in the system over a two-year period, beginning in September of 1992.

In phase 1, we required a complete match of data elements in the HUD insurance system, with the data submitted by the mortgage company, including such things as names and addresses. In phase 2, which began in March of '93, after we recognized that we were getting a high number of rejects simply because the homeowner's property and mailing addresses were not agreeing, we determined, then, that this was primarily because people were selling the homes, and they were moving out, and so we eliminated that requirement. And then we ultimately got, in October of '94, we began what is a completely streamlined process, that reduced those five major steps down to three steps. So what has happened here now is that we stopped generating a refund application at all, so that when an insurance is terminated, when the mortgage company tells us that the insurance has been terminated, this information comes into HUD, that is transported into our disbursement system.

If all of the edicts are met, such as name and address and property, basic information, we simply remit to Treasury -- transmit to Treasury notification that this person is eligible for a refund, so that the check can be cut, and then Treasury issues the check directly to the homeowner. This, then, has changed significantly the time that we've spent. At the end of fiscal year 1995, which was the first full year that we operated under our new process, we saw a significant shift in the manner in which refunds were processed. Thirty-five percent of our refunds were fully processed, without any application from the homeowner. In fiscal year '95, that was about 83,000 applications. Twenty-nine percent of them were automated, and were processed automatically.

For example, the mortgage company might not have included the accurate information, say, about the date that the property was purchased, or the paid-in-full date, just date information or something, so that when the homeowner completed that information, and returned the application, then it would automatically process. We ended up then, having 36 percent of the applications that we received, that staff had to actually physically review. The reason for the actual manual review, and this will continue, there will always be some manual review, is because people die, they get divorces, their name changes, property ownership changes, they have to be verified.

But as we've seen, though, as we've moved along in the process, by the end of last fiscal year, we had had an even more dramatic shift, so that now we are doing 57 percent of our refund applications without any paper coming from the homeowner. This means



that the insurance gets terminated, the information comes into HUD, and we send to Treasury the information to generate a check. Twenty-one percent are automated upon submission of the refund application, with the minor changes by the homeowner, we are now doing only 22 percent manually, which is a significant savings. With these improvements in the processing time, came benefits to both HUD and to the homeowner. For the homeowner, it reduces the time that it takes them to receive a check, it saves them the expense of having to get documents notarized, to reproduce them, to mail them to HUD. It also reduces the time that they have to spend calling us and writing us to find out what happened to their application.

On the HUD side, it gives us a more efficient mechanism of delivering government services to our homeowners, it eliminates the handling. Previously we had to open, key all of these documents, and also with staff processing time, we estimate with the actual applications and all of the attachments that had been required, there are probably about 8 million documents that somebody had to do something with during a year. This also supports our department paperless processing, and it has lessened all reliance on contractors. In addition to the intangible benefits, we can attribute some direct cost savings for this program. We estimate that annually it saves us about 453 thousand dollars, about 288 thousand of which is simply for processing the applications. Every application that came in, had to be handled and something had to be done with it.

In addition, we are looking at, perhaps about 165 thousand dollars in staff savings. Prior to entering into our streamlined process, we had eight staff members devoted to homeowner refunds and we still had backlogs. Today we have five staff people for processing refunds without a backlog. The good thing about this is that our savings are continuous without any additional outlays. So this streamlined process has enabled us to respond to all customers in a timely and professional manner, reducing the response time from over 120 days, to less than 10 days, for 78 percent of the homeowners. We are still continuing to identify practices that will further enhance our customer responsiveness and implement the paperless process and initiatives.

MODERATOR STANTON: Thank you very much, Ann.

I don't know if they need lights or not for the TV part of this. Now we would like to invite to the podium Carl Wasson, of the Department of Veteran's Affairs, another agency that really does treat the people it serves as customers and with Carl, we will be talking about his special servicing of borrowers who get into trouble. I've looked at the credit score reports, and other things Veteran's Administration as does FHA, makes loans to a number of people who might not be well served by the private, commercial market, and unfavorable terms.

What that means is, they have a higher percent of borrowers who might become troubled, and special servicing is one way to help those borrowers, so that you can serve them well and not have people who are hurt with defaults, or taxpayers who have to pay claims.

MR. WASSON: Thank you. Good morning. As was just stated, the VA way to try to provide customer service in our home loan program, is through supplemental servicing, personal supplemental servicing by VA loan service representatives.

Most of you probably know about the VA home loan program. It was started near the end of World War II as a grateful nation was trying to honor the veterans who had served our country so well during that war. What the VA home loan program was all about, was replacing the traditional down payment that was involved in obtaining a home mortgage, with a government guarantee.

The guarantee could range as high as 60 percent. In the early days, a veteran had a certain bank of entitlement that was only about 2,000 dollars. These days, that bank of entitlement is up to 50,750 dollars. The program has been very popular with veterans; we've just recently had a ceremony in honor of our 15th million loan that was guaranteed by VA. We have a total of 210 billion dollars in loans outstanding at this time. Associated with those loans, there is a potential liability, under our guarantee, of 66 billion dollars.

With that type of potential liability, naturally we need to have some type of risk management program. Our program at VA is personal supplemental servicing. This also fits in well with VA's overall mission, which can be -- has been stated many times, by quoting Abraham Lincoln. I believe it was in the Gettysburg address where he said that "we should care for him who has borne the battle, for his widow, and for his orphan." And, again, that is what VA tries to do. We are the Department of Veteran's Affairs, and we are providing benefits to veterans, because they have served in the military service of our country. Of course, when you talk about VA supplemental servicing, the question that always comes up from a financial standpoint is, how effective is this servicing? It has been around almost since the inception of the VA home loan program, where we had loan service reps that have been available to talk with veterans who find themselves in financial difficulties.

Under our regulations, mortgage companies who actually make the loans that are guaranteed by VA, are required to report to VA when the loans are delinquent. The way our regulations read, they have to be reported no later than 15 days after four payments are due on the loan. Certainly that is a pretty serious loan default. What we found, over the years though, namely in the past, by anecdotal evidence, is that VA supplemental servicing has been able to help veterans, even at that late stage of the delinquency, to cure the delinquency, be able to reinstate their loans, to find other alternatives so that they do not face foreclosure.

In the mid to early '70s, we finally got around to developing a computer system to track the defaults that were reported to VA. Along with that system, we tracked a number of contacts that we made with veterans whose loans had been reported in default. In the '80s, as the oil patch disaster came along, very often the VA home loan program was known as the troubled VA home loan program, because we were paying out so much in the way of claims.

VA's home loan program was funded, basically, with a revolving fund. And for a number of years, with the real estate appreciation in the '70s, if a loan happened to be foreclosed, and VA acquired the property following foreclosure, we were able to turn around and resell that property as it had appreciated, and it would work out pretty well.

But with all the defaults in the mid-'80s, that stopped, and Congress had to start making appropriations into our revolving fund. So there was an awful lot of interest in terms of what can VA do to prevent foreclosures if at all possible. Well, one thing we developed, we added a little bit to our computer tracking system, so that we could check on intervention actions by VA. This would be where VA typically would receive a call from a veteran borrower who was in default. The VA might analyze the situation and decide that yes, something could be worked out to save that veteran's home. When we would do that, then, it would be incumbent upon the loan service representative to contact the mortgage company, and try to confirm that yes, they would be willing to go along with that repayment plan. We would track that in our system, if the plan was successful, then we would have a successful intervention action.

So there were a number of types of plans that could be possible. Of course, the primary one is a repayment plan, where eventually the loan is repaid. In some cases, maybe we might delay foreclosure action a little bit, in order to give the veteran time to sell the property. Whatever the situation was, we did try to track those actions. Also, in the '80s, another example of trying to determine how effective VA supplemental servicing was, we established a pilot servicing project in Houston, Texas.

We have a VA regional office there, and of course Houston was hard hit by the defaults in the oil patch area. What we did in Houston was make arrangements for ten additional loan servicing personnel. And we also made sure that we tracked the results very closely of those personnel. We had to do an awful lot more tracking than what was available in our regular computer system, at the time. We also developed a ratio to try to identify the impact of VA service. This ratio is called a FAVAIR, which was basically "foreclosure avoidance with VA involvement ratio." It tracked the number of successful interventions that occurred, plus the number of cases where VA purchased a loan because the holder would no longer extend forbearance, but where VA felt that the veteran could eventually reinstate that loan, if given a little bit more time.

Also tracked were the number of cases where VA took a voluntary conveyance, a deed in lieu of foreclosure. In addition to that, even in the late '80s, VA was tracking what is typically known these days, as "short sales." We had them on our operating manuals, available for a number of years. We called them "compromise claims." This is basically where someone goes to sell their home, and unfortunately the proceeds of the sale are not sufficient to satisfy the mortgage balance. So VA is able to step in, in many cases, and pay what we call a compromise claim. It is beneficial to the government, because it is less than would be

payable if the loan went on to foreclosure. So we track these various intervention actions that VA might perform, and compared them to the number of foreclosures that actually occurred. And this was our FAVAIR ratio, foreclosure avoidance with VA involvement ratio.

As far as the Houston project goes, we found that in just a one year period, with the addition of these ten loan service reps, that we were able to save about 11 million dollars in claims that would have otherwise been payable if we had not had the successful interventions, the deeds in lieu of foreclosure, the compromise claims, or the refundings by VA. After the Houston pilot project, we decided that FAVAIR should be implemented on a nation-wide basis, and we established goals for all of our regional offices to try to accomplish. We also added some weights in the FAVAIR ratio to reflect the relative benefit of each one of those alternatives to VA.

Eventually we changed this ratio from FAVAIR, and came up with a new name for it, FATS, which is "foreclosure avoidance through servicing." The FATS ratio is computed a little bit differently, in that what we do is take a look and say, if these alternatives have not been completed, there probably would have been foreclosures. So therefore, if we add the alternatives to the foreclosures, use that as our denominator in computing the ratio, for the numerator of the ratio, we have all of the alternatives, then we can come up with a percentage figure that basically tells us what would have happened if VA had not intervened and serviced those loans, and arranged those alternatives. That may have been a little bit complicated without a visual aid, but just as an example, consider if we had five cases where VA was able to arrange successful interventions.

At the same time, say for that particular period, there were five foreclosures at that particular VA office. What we would then do is say, the five intervention actions, divided by the five intervention actions plus the actual foreclosures that occurred, and we come up with a ratio of about 50 percent, meaning that VA avoided claim payments in 50 percent of the cases that could have occurred. Okay, so much for FATS. What does it mean? Fifty percent is probably a little bit high. It would be nice to shoot for, but we are not really sure that that would be realistic. Over the last few years, in fiscal year '95, we did have a FATS ratio of 37.33 percent. This doesn't correspond exactly to the total number of foreclosures that were avoided, but fairly close. And it really shows the benefit to VA of personal supplemental servicing, and arranging alternatives to foreclosure.

Our '96 goal is 39.19, and for the first three quarters, of course we don't have the year-end figures, yet. But for the first three quarters of the year, we are already at 41.69. And the FATS goal has been incorporated into our GPRA plan. The Government Performance and Results Act of '93. What does this all mean from a financial standpoint to VA? Well, certainly from the FATS you can see that it looks like VA has documented that we have avoided foreclosures in a lot of cases. From a dollar standpoint, if we look really, the main one where we can come up with a somewhat realistic estimate of dollar cost avoidance, would be in the

successful interventions.

In those cases, the loan is actually reinstated, there is no foreclosure at all. In the other cases, if you have a deed in lieu of foreclosure, you should be saving a little bit in terms of the accrued interest on the loan. However, it varies so much from case to case. But if we go back and look at those successful interventions, and look at the number during fiscal year FY95, when our average claim payment was something like 16,000 dollars, and we had over 5,700 successful interventions nation-wide, then we come out with a figure that VA saved 93 million dollars in claim avoidance.

For the past three fiscal years, our total has been over 255 million dollars in claims avoided as a direct result of VA supplemental servicing. Also, we can take a look at the individual numbers. If we look at the number of loan service representatives that we had nation-wide, divide those into the cost figures, it comes out to something like almost 330,000 dollars per loan service rep in the savings and claim avoidance. Now, that is a pretty good savings, when you think about the average salary for government workers, as compared to 330,000 dollars per year in savings. This dollar figure, of course, doesn't take into account the refunding cases, where VA was able to acquire the loans, keep the veterans in their home, and the savings that were associated with the compromise claims, or the deeds in lieu of foreclosure, where the savings vary so much from case to case.

One big question might be, why is VA so successful? Well, number one I think it is because we are the Department of Veterans Affairs, we do try to keep in mind the quotation from Abraham Lincoln, and veterans, basically, respond better to VA, than they do to their mortgage companies, or to some third party, such as maybe a local counseling agency that might be available to help them. VA also has a better understanding of veterans, and of our operation of our loan program. Very often we are able to simply counsel veterans and their spouses, the time frames that are involved by our regulations, that are required before a loan holder can foreclose, and the folks decide, okay, yes, we should be able to accumulate sufficient funds to reinstate the account before that time frame is up. It puts their minds at ease, and they are able to stay in the house, as opposed to being so concerned by the contact from the mortgage company that they simply go ahead and move out.

We've also had a lot of training with VA, since 1989 we've had centralized training available. Of course, in times of budget cuts, that is changing a little bit, we are moving a little bit more toward the computer based training that we are developing several courses. We are also moving toward satellite training, where we have the opportunity for interactive training sessions. All in all, we are certainly looking forward to the years ahead, with VA, to try to continue our personal supplemental servicing. To help veterans remain in their homes, if at all possible, or at least to arrange an alternative that is less costly to them and the government. At the same time, we are planning to save the government an awful lot of money by

ensuring that we don't have to pay claims if we really don't have to.

Thank you.

MODERATOR STANTON: Thank you very much, Carl. Our next speaker is Dennis Peacock from HUD. And now we are going to shift from individual customer service, as we heard in the first three presentations, to a concept of trying to map service to large groups of customers in specific places.

Dennis?

MR. PEACOCK: Hi. I work for the Office of Information Technology, a year ago, July, we were requested to develop a system to map all types of assets, to any place in the country. The system is called the Place Based System, and we are going to show you some slides of the system. And it was developed based on the secretary of HUD's vision to make the department much more place-based, or community-based.

The system is a custom developed, client server application, using Microsoft visual basic and the system is a warehouse of data that contains 7.6 million records of data. We take all that data, we geo-code it, all the way down to longitude and latitude, and we can display HUD's information by any place in the country. We are able to start from HUD's regions, and we draw down -- and you can see the data by the nation, by any state, city, county, MSA or congressional district.

HUD is broken up by four major areas, community program development, housing, FAEHO, fair housing equal opportunity, and public housing. We've taken all the data and given it a single theme, so there is a oneness of data. All the data comes from 15 Legacy Systems that run on separate platforms, the Unisys mainframe, IBM mainframe, and LAN-based systems. We also add to it. If you will see, down at the bottom right side, a little hard to see, demographic data from the census department.

Right now you can see the census data, economic data. The next screen is a display of all the financial information related to community program development, and that is for the nation. Again, we can show the same view by almost any place in the country. Housing; as you see at the top here, there are six and a half million insured mortgages for 393 billion dollars, and it just goes on to all the HUD assets, the notes, the acquired properties, for a single family, the same thing for multifamily. Title 1, which is home improvement loans, and manufactured home loans. We can do the same thing for that. And we also have Section 8, which is real assistance and construction, etcetera.

We are able to show you the fair housing information, and we can break that down and show it by the type of complaints for fair housing, and the types of settlements for fair housing, again, by any place in the country. The last screen is showing you the public community housing, and we break that up by public housing, and native american housing. We are going to go into the mapping feature. This is where we drill down, and you can see the information by state, we've already selected the state. Beginning to see it within the state by city, congressional district, county, and MSA.

We are going to choose the city of Baltimore. We also see information about the city of Baltimore, we show you some of the political information. Just recently, in the City of Philadelphia, they contacted our field office there, with a running system, a congressman asked for information about everything HUD is doing in that congressional district. They used the system, they provided the information to the congressman within three days. He called the office back, and explained to them, generally it takes a minimum of a month to get the information, so he was quite pleased with the results, not to mention that all the information was consistent, in the same format.

In this screen, we drill down, we are looking at public housing agencies, and we select the housing agency which is the housing agency of Baltimore City. And then we will pick the projects, this is a list of all the projects that HUD grants money to, and a list of all the addresses. So we go all the way down, and everything that is point and click, goes down, and it brings up the map of the city of Baltimore, and we can further drill down and see where the projects are in the city of Baltimore, right down to the street level.

We also have built into the system a function where people can report problems or suggestions within the system, and a place where they can find out help information. Lastly there is also a function within the system where it actually demonstrates the system, they click on a button that is called the "guided tour." This is the problem suggestion screen, and another theme of the system is the fact that it is complete openness with all the information that HUD has. HUD is very compartmentalized right now, so you don't really see everything everybody else is doing. Right now all the information that is in the system rolls out from the very bottom.

The system is installed in the Secretary and the Deputy Secretary's offices and if they want to see how HUD is doing on some program, they can drill all the way down and see the very details of it, wherever the assets are. Lastly, this is a list of all the people that worked on the system and this is an example from the help screen, we use the typical Microsoft help functions. Again, the system is installed with a LAN server out in the hallway, and we'd be more than glad to demonstrate it for anybody who is here.

Thank you very much.

MODERATOR STANTON: As Dennis explained to Frank and me, as we were making our rounds and getting to know this system, this is remarkably valuable for the head of your agency, as he or she rushes on to an airplane, to land at some city in the middle of America, and has to be able to say, here is what we are doing for you. It begins to give you a very direct link between the agency and its constituencies. I hope you do look at the actual live demonstration that Dennis has outside, in the hallway, because the slides don't convey to you the remarkable nature of bringing it from the city level down to the area level, down to the actual street, where a HUD funded project might be located.

Our next speaker is Laura Yeager, from the General Services Administration. Once again, we are on television, and I want to thank the television audience as well, the people from GSA who have been so generous in sharing with us their TV capability and also the room in which we are meeting and the fine facilities. Laura will be talking about government owned real estate, and the way agencies are pooling their efforts to get economies of scale in selling government owned real estate.

MS. YEAGER: Thank you Tom. Rhetoric of cutting costs and delivering a better product to the customer. But we hope you don't call it rhetoric after you see what we've been doing, because it is reality. I tell you what, in the interest of time, let's just go on with the video -- the video would have given you a flavor of what the G.O.R.E project was about. It was a housing fair that we did in Atlanta, Georgia, it was one of our first joint agency housing fairs, where we had 3,300 people come in to learn about all of the agency's different programs.

I'm proud to say that everyone on the panel with me today had a representative booth at the housing fair available to partners in G.O.R.E. G.O.R.E. is the Government Owned Real Estate Project. It is a group of multi-agency real estate professionals that deal with improving the process of delivering properties to the customer. And we'll go into this. And here comes the rhetoric, I think. It began as a partnership, it still is a partnership between the Department of the Treasury, Financial Management Service and the GSA. Frank Kesterman is the big Treasury boss on this. Thank you, Frank, for all your support. We started out in Atlanta, Georgia, about three years ago.

We started out as a small group of the different agencies that you see represented here; the U. S. Marshals Service, the RTC, the FDIC, and some of the other agencies that sell properties that are not mission related properties, they are properties such as -- these properties are taken through default, foreclosure, forfeitures. Therefore they are not mission related properties, and the core mission -- we will switch to overhead.

(Whereupon, a video tape recording was played.)

MS. YEAGER: That was two years ago, and we are going to switch to overheads here. The G.O.R.E. project, again, as Tom said, most of the agencies are focusing now is a focus of trying to cut the cost of acquisition, management and disposal of government owned



real estate. We do it by sharing resources, and sharing information, sharing contracts. Next slide. The main focus started out being just getting together and trying to decide what we needed to do. And after about six months we realized that we were a business, and we realized we had to do a business plan.

Over the three years that we've been a project now, we have become a program, a partnership, we have won the Hammer Award, I'm sure many of you have also done that. But one of our focuses is maximizing asset recovery. In the real estate field, if you are an investor, there are two ways to make a return. And that is either on your desk while you are holding the property, you can get your money by middle man contacts, credits, housing, lower housing allowance. Then you get your ultimate return of your investment when you sell it. The real estate that the government ends up with, you don't really have the opportunity to make a return while you are holding the property. In addition to that you have carrying costs. So our focus is to try to get the return of the investment as quickly as possible, thereby cutting the carrying costs.

When we started out, as I said, we started out not knowing exactly what we were going to do. We had somewhat of a blueprint. But the trends in business over the past few years have caused us to change. The downsizing in agencies, people are beginning to be generalists rather than specialists. There is a focus on core mission. I think it was Carl that was telling us that the VA was put into place back in the '40s, after the war, to take care of veterans.

We know that SBA had its own reason for being, and I believe that was somewhat related to small business men, and making sure that they were taken care of, because big businesses were taken care of because of war manufacturing and things like that. One of our partners is the U. S. Marshall Service. You may or may not know that they were actually brought into being probably back in the days of the pony express, that was the first thing that they were required to do. So we have a focus of a mission now, you have less time to do the things that are not mission related, and so therefore, the G.O.R.E. real estate team can take care of some of these things. We have an environment in business, today, which demands change.

This means we have to stay in constant contact with our customers, we have to have constant feedback to see what it is that they need. We have very sophisticated customers out there, specially in the real estate field. We need to know what they need, and we need to provide it, because if we don't someone else is going to provide it. Information superhighway, back in the old days, when you wanted something -- groceries, you went to the grocery store. When you wanted books you went to the book store. Now you get on the highway and you go down to Wal-Mart and you can get everything there. One-stop shopping, that is what the customer wants, specially in real estate. Multiple listing services, that is what they want. We are going to provide that. We are not going to say we can't provide you information on the government agencies. The government is the government.

So in our efforts, we have taught real estate fairs, we have trade shows

and auctions, you saw the video on one of the real estate fairs. We have inter-agency meetings. G.O.R.E. is nation-wide now, and we have agencies coming together in all parts of the country, working on their own specific, individual problems, some of them are different in other areas. As Carl was also saying, down in Houston they have different problems, because of things like the oil patch that troubled VA back in the '80s. They have different problems in areas where they have environmental concerns. We do networking with each other, we -- bartering, I don't know, I'm a little reluctant to talk about that, because with all of you accountants in the room, I presume, I'm not sure there are audit trails to bartering, so we won't say too much about that, except that we do trade off services when we can.

If I have something that VA needs, and they have something that I need, we trade off on those. We have so many partnerships, I couldn't begin to tell you, between each other, we have partnerships between state and local agencies, and the private sector. On the next slide you will see one of the partnerships we are very excited about. Sandra Robins just had a funny look on her face, the lady in the red out here, is on our New England G.O.R.E. team. And just in the last week, I think it was, Sandra addressed a forum to the National Partnership with Connecticut's Neighborhood Revitalization Zone.

This is a partnership between HUD, the President's Council, EPA, OMB and the heads of the State of Connecticut, the Governor of Connecticut; a lot of people are involved in this partnership. This particular forum was on the problem of what to do with all the mortgage foreclosures. They asked the G.O.R.E. Project to spearhead a single source of information for them to have the early listings of all those properties. They can, in turn, turn those into the communities, so that people can have access to the incentive programs offered by the various agencies, such as FHA's foreclosure avoidance program, loss mitigation program. We have run into situations in other cities where a Mayor of a particular city has said, I know that I come to one particular agency and ask them how many properties they had. They had that information, they may or may not have the entire federal compilation situation there. I need to know what is going on in my city.

Typically, if you have problems in one area with HUD properties, you are going to have the same thing with SBA, VA and so forth, because of the economic factors and so forth involved. This is an important tool for communities to fight against the problem of foreclosed properties. That comes down to an electronic clearing house and this feeds right into what Dennis was saying, and Dennis and I have talked about this, already, we are going to talk about it some more. With an electronic clearing house of all these agencies' information, we could use the high quality information as a leverage. Already, through this process, we have created many internet links with our federal and state partners. We have a G.O.R.E. home page. Out at our exhibit we have our home page address. It is too long, I can't remember it. I know it starts with "HTTP" and ends with ".gov," but the rest of it is out on the exhibit.

We have a place to market our properties on federal, state and local

government. When we have a G.O.R.E. auction, you can go into the G.O.R.E. home page, you will be automatically linked into whomever the contractor is for the auctions home page. That is a requirement. If you were an auctioneer that does a G.O.R.E. sale, you have to provide us a hyperlink with a database and inventory, so that anybody buying property from that sale, can get into the database through Internet and look at that. These are the things we have already created, and I have to credit Frank and the Federal Credit Policy Working Group, the CFO's school with getting us set up with a lot of these. Cristy McFerren sitting here on the stage sets up our hyperlinks to GSA.

A lot of this is the result of what we are doing here, in this type of a forum. And right now, when you go into the GSA home page, you go into G.O.R.E., you are automatically hyperlinked, or you can choose these options. You can go with the HUD homepage, you can see all of the programs that HUD offers, as well as the HUD auctioneer, which would be Larry Latham, and all the properties that they have for sale through auctions. You can go to the VA, the Department of Agriculture (USDA), US Postal Service, the FinanceNet, and then the FinanceNet spins off into another whole area. You see, over to the left to the screen, Pike Net, that is a commercial real estate network.

They have asked us if they can hook into ours in order to provide that to their customers. At first we weren't sure about that, and then we said, "Wait a second, this is like being a broker in a real estate office. Do we care how many people come in and hang their license on our wall, no we don't, because we are going to get the sale anyway." There are many uses for the database. In addition to marketing and forecasting, if we have all this information coming in to one place, we can use it for things like sharing contracts, we can -- over to the left you can see the socio-economic, that is the things we were talking about, communities need that information. That spins off into another -- into other databases, where you have the available programs to help those people in the communities.

Special legislation. Many types of property fall under special legislation. If we have a profile that a certain piece of property fits into, such as Everglades restoration, we can then take whatever measures are necessary to deal with that property. And all the information is there for us to manage. This is an example of the way you run an environmental reference database. Environmental is becoming a big problem in selling real estate these days, for agencies. When a property would go to the G.O.R.E. database, the environmental reference database, the profile special category would be something like lead-based paint, asbestos, PCB's, underground storage tanks. That would kick it through the environmental reference database that has already been established by prior entries through this database, then that would kick it into the requirements for a particular thing.

For example, lead-based paint, you have to disclose that at sale, but it

only applies to residential property. This is a good tool for the agencies, because agencies are somewhat stymied by not knowing exactly how all the requirements fit in. It is a big burden, and this way it would just run through a screening process, and then we would have the information handy. Then we go back to environmental reference list, this is a commercial type database that is set up to identify further categories. Such as -- this is on the superfund list, things like that.

And then it goes back and tells the agency this is what you need to do with this property. And then it goes back and it feeds into the reference database. The process for putting your property on the database, this is how it cuts cycle time. If the property goes to a broker, this is typical with SBA, some of the other agencies, it doesn't sell in six months, if SBA has a particular office that is very, very busy, they may or may not be able to handle that right at the time. I'm not saying that they aren't, but I'm just saying that this is an example. And they may not know what happens to that property after six months. The broker hasn't done anything with it, okay. If it goes into a G.O.R.E. database, it automatically kicks it into an auction cue, and it is set up for sale, and then it is turned into money. This is just a simple way that cutting the costs work. The two agencies have individual auctions, they incur different costs at about the same rate. When they combine, they can split it up to 50 percent.

Simply put, it costs as much to market 50 properties as it does 150. On the next screen you will see that the more that you put in, the higher the volume, the less the costs. Nationwide results, this is the glitz. In three years we have sold, nationwide, through G.O.R.E. auctions, 1,677 properties, and we've brought in 73.8 million dollars in sales. Now, this is where we are, the benefits. Obviously they are pretty obvious. Best business practices are identified and put into place. Not rhetoric. The community is being educated, we have reduced cycle time, efficient asset management. And that leads to maximum asset recovery, which leads to better accountability to all your stake holders, whether that be congress, whether that be your own individual CFO, your agency, or the man on the street.

Our current initiatives, we are -- through the Federal Credit Policy, we have been able to establish many, many -- we have established the internet hyperlinks, we now have a working group with HUD where we are working on cutting the cost of auctions through contracts. We've established a lot of agency partnerships. All the agencies have been very cooperative in helping us work on cutting these costs. We have done surveys to try to find out the volume of business, so that we know where to take our plan in the future. We are working with Frank to estimate the cost of broker versus auction. We are not sure what we want to do with that. And now, just as of yesterday, after meeting Dennis Peacock and his staff, Joe Duffy out there, I see, we have added another bullet, and we are going to do a working group for a database to tie this wonderful HUD database that he was talking about, this place-based system, which I took the liberty to try to draw on my own.

Now, Vice President Al Gore has told us that nowadays that is going to

be a new phrase, and good enough for government work means it has to be a certain standard before it can be good enough for government work. So that is where we are, today, and again, I want to thank Frank Kesterman for his partnership with us, and I see Tom Stanton out there and all of you for coming today.

Thank you.

MODERATOR STANTON: One of the real pleasures that Frank and I had, as we went from agency to agency, was the real willingness of people. And I think this is a really positive change over time. But real willingness, eagerness of people to share their good ideas with each other. So at this point, before Frank and I have questions, let's throw it open to questions, both from the audience, and from anybody that would like to telephone in from some of the remote sites, to 1-888-924-3246.

Are there questions for any of our panel?

PARTICIPANT: My question is to Dennis, and dissemination, so far, in what is planned for G.O.R.E. system?

MR. PEACOCK: The place-based system is about to be installed in all of the HUD's field offices. It runs under Windows 95 platform, and it has not yet been distributed at HUD, so starting probably in January, it will be installed in the new desktop that has Windows 95. We intend, also, to continue to expand the system, we'd like to include the crime statistics, perhaps have some relationship with FEMA, for like a disaster area, since we have the longitude and latitude. If we could get the information from FEMA, we could sort of map all the properties that HUD might have in an area that are covered by a disaster. So there are a lot of things we'd like to expand.

We have done a prototype for the Internet. I have to admit we have to do some more work on the quality of the information we have. There are a number of assets that HUD has without an address and the address of all the assets was the basis for the entire system, but it will eventually show up on the Internet.

MODERATOR STANTON: Other questions?

PARTICIPANT: I have a question for Gail. What kind of information is available to customers using the net?

MS. BEYNON: The kind of information that we have available is balance information, payoff information, when is your next payment going to be debited from your checking account if you are in the pre-authorized debit system. The information, principle and interest breakdown on the last 5 payments, is available. And you can have this information

faxed to you, and at the same time you can tell the system that you want to make a payment on the third, in the amount of 100 dollars from your checking account. And we can take care of it for you.

We keep a record of all actions that are generated, such as changing PIN numbers, and authorization to make payments, or to change the amount of the payment. On the inquiry type information, we just keep account of the number of calls. I'm sorry, did I answer your question, or did I get off base?

PARTICIPANT: No, that is fine.

MS. BEYNON: Okay.

MODERATOR KESTERMAN: Your credit refund system, is that EDI based, automated refund system?

MS. BAIRD-BRIDGES: No, not - no, it is not. The information, the combination information is going to be EDI now, we just mandated that, so we can start getting determinations.

MODERATOR KESTERMAN: How do you involve the mortgage companies in the process?

MS. BAIRD-BRIDGES: The mortgage companies are just involved by the termination. They are required, whenever the insurance terminates, to notify HUD, and so that triggers the process. And that had been a paper process, but that is what is moving to electronic. So actually beginning this fiscal year, just now, we are phasing in the larger agencies that are required to transmit that information by EDI. In 1997, all of it will come in electronically.

MODERATOR STANTON: I've got a question, particularly for Ann and Gail, but maybe also for Dennis and the other panelists. You are agents of change, you have done things differently. That means some people have more to do, other people have less work to do. There are a lot of different relationships involved. Can you talk a little about that process, and any advice for other agencies that want to do -- I mean, this whole concept of process re-engineering sounds great in theory.

Can you give us a little on the practical side, and sort of the people issues involved on getting a new way of doing business?

MS. BAIRD-BRIDGES: Well, I think for us, actually, the new processes came along at a good time, because during this time we had drastic staff reductions. If we had not had improved processes, we would not be able to do our work. So it has kind of worked out in that with the loss of staff people, there haven't been as drastic changes in what they are doing. Now, we are probably moving into things that will change that. And there have been

some internal seminars, and just sessions on how to manage that change so that people begin to be more comfortable knowing that you may not continue to do exactly what you are doing today, but there is a place for you within the organization.

MS. BEYNON: Well, with us, obviously if we have less people calling our field offices, and asking, what is my balance, or when is my next payment due, or questions of this nature, then the people in the offices have more time to work on the real job, which is getting out to the people that aren't calling, and getting their collections in.

I mean, we started with Birmingham, which is a collection center. And so this system really allows the collectors more time to actively collect. Now, when we got into this, we have our program people, the automation staff, and the field people, involved in scripting the voice that the robot operator uses. It took about three to four months to nail down the actual script and responses. The hardware and software that we purchased for this, ran around 100,000 dollars.

This one system is going to serve the entire country and it will do it with no delays. We have, you know, three or -- three other collection centers that deal with our consumer loans, we have two collection centers that deal with our commercial loans. These are going to be the next offices that we bring on to this system, immediately, because we are going to get, of course, the biggest bang for the buck there. We were about ready to go on-line with this, when we had our brief interrupt last December and January, you know, when nobody came to work. That kind of set us back a bit, because the company, of course, went on to deal with their other customers who could work with them, and then they had to get back with us.

But we are very, very happy with the way the system is working. We are getting the TTY calls, as well as -- I mean, the statistics, you know, we keep counts on the TTY and TDD calls that we get as well as all the rest of them. Specifically, there have been no hang-ups on the lines, nobody has been waiting, I mean, it is working great.

MODERATOR STANTON: On that happy note we will say goodbye to our television audience, and resume the TV broadcast at 2 o'clock this afternoon, from 2 until 3:30. We will resume the TV broadcast sort of partially into the electronic data interchange panel, and go from there.

I don't know, Dennis, did you want to add something on how do you get resources for a vision of something new that HUD hasn't done before?

MR. PEACOCK: Actually, we are very

fortunate. This is something requested by the Secretary of HUD, and we assembled a first rate team of people to work on the project. It was still a bit difficult collecting all the data, and making arrangements with -- because they are very departmentalized, it is sort of like their own set of little HUDs, out there.

But it is still coming around. Very nice thing is that everybody can see each other's data. So if you are working one side of HUD, you are like CPD, and another side, the PIH, everything is very open about all the information. All the information on the system can be downloaded to your PC just by clicking on a button. You can see the quality of the information and the information that you can see, can also be seen by the Secretary. So it is causing things to be changed and cleaned up very nicely.

MODERATOR STANTON: I don't know if I can ask you a question, Frank, but you are involved with G.O.R.E., and maybe Laura wants to answer some of this. I thought Laura put it very nicely that as agencies have less resources to concentrate on their mission, you may want to spin out some of the non-mission related tasks like, hey, if we are in the business of providing housing, and we've got all these defaults, give that to somebody else to deal with. How easy or hard is it to get agencies to think in a much more cooperative mode, about sharing resources?

MODERATOR KESTERMAN: HUD is very important, it is vital to G.O.R.E., because we share problems, and we have a good relationship and we want to build on that relationship and we need to develop more sources of products. To that end, I think looking at local communities, maybe you can tell us a little more about it, that is kind of like the leading edge.

MS. YEAGER: Okay. This piggybacks right into what Dennis was talking about, the type of information that Dennis is talking about in the place-based system, is the very type of information that the cities are looking at, the states are looking at. Federal Government services are really -- I guess the states are looking at wanting to take over -- they don't want the Federal Government to be into their area. They consider it their territory and they would like to deal with those services at their level, if they can. But we need to help them, though. There are all these programs, and HUD has a lot of the partnerships, in revitalization, neighborhoods, there is the presidential initiative called the enterprise zone and helmet communities. This is where all the agencies come together, and you can identify it by a zip code, the property that falls within this community, and then there is a spectrum of federal services that are available to that particular zip code.

Same thing with state and local services. There is a need to have all of this stuff in one place. It is a, I think, a trend in government, in general. We know, nowadays, you have a computer system which matches up all of the benefits that a person gets. Like a person goes in to apply for food stamps, they now are somehow in the system matched into, it is a



potential that is also a management tool for giving out allowances and so forth. It is the same thing with housing and programs like that. We need to know all in one place, what is going on in a community. The problems in a community are common among the federal population.

Our four partners have just been incredibly cooperative, as Frank has said. HUD, through the sheer volume of their business has been one of our biggest partners. The CFO's and other department heads to an agency have said, we want to cut costs, what can we do, how can we help? HUD has a system for providing graphic information. I think that other agencies have similar systems, and we want to tie them all together and put them in one place, so that we can have a single source of information.

MODERATOR STANTON: Thank you. It looks like Dennis may have some business at the state and local level. Was there one more question, and then we will break?

PARTICIPANT: Hi, I wanted to ask Dennis if there were any plans to overlay like SBA dollars or welfare dollars or anything like that, onto your system so that there will be a way of possibly re-engineering the money flows, as far as seeing where the federal purse is going on a neighborhood by neighborhood basis.

MR. PEACOCK: There are no plans for that, but we -- I mean, there are things we just can't know. So, I mean, we are open to any suggestions from anybody. We'd even like to get demographics from people who receive food stamps. So we are not excluding anything.

PARTICIPANT: Are there any plans for putting this on the web so that the public has a right to use it?

MR. PEACOCK: Yes. We have plans to put it on the web.

PARTICIPANT: Any time?

MR. PEACOCK: We've already done a pilot, we still need to clean up some information. Probably somewhere close to six months, maybe less.

MODERATOR STANTON: One last question, if you will bear with us.

PARTICIPANT: I'd like to ask Tom , he has published the facility that the government has the tendency to -- and what projects do you have in mind that you would like to do that the government should do?

MODERATOR STANTON: Projects that the government should do with respect to?

PARTICIPANT: Monitoring.

MODERATOR STANTON: With respect to monitoring. That goes back to the earlier session. Just to wrap that up. It was my sense, as we heard the panel this morning on financial early warning systems, that it would really benefit the government to have a central location where you had a very small but very capable staff. This is what the Fed was talking about. I mean, you could do it with a handful of people, to sit there, work with individual agencies, and try to generate some sort of early warning about places where the government was going to have some sort of significant financial risk, do it in advance, and then work with the agency to take some sort of protective steps along the lines of what we heard in the earlier panel.

I think that would be immensely cost effective, it would cost almost nothing to set up a small group of people like that, and as the panel this morning talked about, even a little bit of prevention would pay for that, many times over.

MODERATOR KESTERMAN: As Director of Risk Assessment at FMS Treasury, that is just exactly the kind of thing that I wanted to hear, because we are trying to foster a culture of risk throughout government, and we look forward to cooperating, wherever we can, with organizations that want to create a risk assessment unit, and that is why we've had a lot of risk-related people here, today.

MODERATOR STANTON: Thank you very much. It was a real pleasure. Thank you panelists, one more excellent panel. Let's give them a hand and come back at 1:30.

(Whereupon, the above entitled matter was recessed for a luncheon break at 12:37 p.m. and went back on the record at 1:38 p.m.)

### AFTERNOON SESSION

1:38 p.m.

MODERATOR KESTERMAN: Welcome back to our afternoon session. This afternoon we are going to be dealing with electronic information, with the movement of electronic data and electronic payments, in a lot of different ways. We have an interesting panel that will cover agencies that are making payments, agencies that are using data for analysis.

The first speaker will be from Price Waterhouse. This will be a joint paper, SBA and Price Waterhouse. Price Waterhouse was the contractor that designed the system, the electronic system for analyzing SBA's loan portfolios.

Meera Ramachandran from Price Waterhouse will be our first speaker.

MS. RAMACHANDRAN: I want to talk to you a little bit, today, and describe a project that we conducted for the Small Business Administration, and which talks about how EDI could be used quite effectively, in collecting large amounts of information, and how we converted a paper-based system to an electronic system as SBA, and conducted a pilot project in that area.

Now, SBA guarantees loans through about over 8,000 commercial banks all over the country, and they have 12,000 reporting locations, so it is quite a number of locations to deal with, and the banks are currently reporting on a quarterly basis, it is a paper based report. SBA sends out this form, to the banks, the banks fill the information in manually, and mail it back to SBA.

SBA has to key enter all the information in, into their in-house application systems. At one point SBA said that they needed monthly reports, and needed to increase the amount of information that we are getting from banks. The reporting requirements are real simple for SBA. They send out a request for loan status to lenders, and they get loan status information back from the lenders.

SBA took a look at a number of different technical alternatives. They looked at a dial-up system that allowed lenders to just sort of dial in, and update loan status information. They looked at maybe using some third party services to collect the volume of information, you know, getting information on disks, tapes, etcetera and they also looked at electronic data interchange. They selected the EDI for several reasons. Information that is sent through EDI, through a value-added network, is received fairly -- I mean, it is very quick, there is no communication lag time, it only takes a few minutes for the loan status request to be sent to the lenders electronic mail box, and for a loan status information to be received back from the lenders.

The whole reporting cycle can be carried out overnight. And since all the data is electronic, and it comes back in and systems are updated automatically, it completely eliminates manual data entry. There is also no handling of media. If you think of paper, opening, you know, tens of thousands of envelopes, or popping diskettes in and out of the system, or magnetic tapes, that is a lot of manual labor, and EDI eliminates that because it is machine to machine communication.

All these factors made monthly reporting possible. Some of the other things about EDI, even though it is machine to machine communication, because there is a third party network in between, it reduces all the security risks. It is not as though you are giving somebody access to dial into your application systems. There are also all kinds of software and network options out there, that SBA could take advantage of. Once they set up an EDI path to

their lenders, they could use it for other kinds of reporting, and you will see how some of it has been used. Also, lenders could then use the same software, the same network services to talk to other credit granting agencies. So those were the reasons that SBA selected EDI.

Now, in order to conduct a pilot to prove the viability of EDI for this particular reporting, status reporting system, they selected a few of their lenders. What we wanted was a selection of lenders that were geographically distributed to show that we could receive, send and retrieve data to any part of the country, you know, some large lenders, who had large portfolios, a couple who had one or two loans. And they also wanted to use lenders who had varying degrees of technical sophistication, people who don't even have computers, no PC's, no modems, to some very large data processing shops, or third party services. So SBA conducted a preliminary survey of about 50 of their lenders, asked them a number of questions, and out of those they selected 12 lenders to participate in the pilot. Now, this looks like a very complicated picture, and I'll try to walk you through it, okay? On the top right-hand side, I'm not sure you can read this very well. If you would like copies, I would be glad to provide hard copies to you afterwards.

On the top right-hand side, we have the Small Business Administration, the SBA, and they have an in-house reporting system. So the loan status request is automatically extracted from that system, passed through an EDI system, which is basically a PC-based front end system, through a value-added network and it can get to lenders in one of two ways. For lenders, larger lenders with large portfolios, who had EDI systems or who wanted to use EDI, they would be able to receive the data through their EDI systems, as an EDI message update the information from their in-house systems, send the data back to SBA through the value-added network.

Now, SBA is also dealing with some lenders who didn't have EDI capabilities, who were too small to want to develop EDI capabilities, or lenders who had only one or two guaranteed loans, so it didn't make it worthwhile for them. Now, for these lenders, SBA provided a voice response option. The request for loan status would be transmitted to them as a fax message. SBA would send it out as an EDI message, we had a third party service provider who would convert the EDI data into a fax, a hard copy fax, and automatically send it to the lender's fax machine.

Once the lender got that request for loan status information, they would use a touch tone telephone, call an 800 number, which would prompt them, using a series of voice prompts, just like a telephone banking system, and say, enter the loan number, enter the outstanding principle balance, etcetera. Now, that information would be converted back to an EDI message by the voice response service provider, and sent through the value added network to SBA. So to SBA it really didn't make any difference as to what option the lender used on the

other end, because they would send the information out the same way, and receive the information back the same way.

Now, an added advantage to the lenders, in this situation, was the fact that on a monthly basis they were already creating and sending a paper report out to the fiscal transfer agent, for loans that had been sold in the secondary market, and that was approximately 40 percent of SBA's portfolio. The data needs of the fiscal transfer agent and the new data needs for SBA were almost identical, so we -- SBA coordinated with the FDA, and they combined the two reports into one.

When the lenders sent out that EDI message, or the voice response message, one of the things they would do is they would mark loans that had been sold into a secondary market, as such. A copy of the data for those loans would be sent to the fiscal transfer agent, automatically, through the network. So the lender was able to combine both forms of reporting into a single electronic report that they could produce automatically from their systems. For the pilot, SBA decided to try out a variety of options. SBA self-selected commercial off-the-shelf software, in a way, to minimize programming efforts. Let's find something that is out there and just use it, and they were able to do this successfully.

The EDI lenders could either use their own EDI translation software, whatever they had available, or they could use some custom software provided by SBA, or SBA also provided them -- a couple of lenders with off-the-shelf software packages, just to see how different lenders would -- how fast they could come up on the new electronic system using the different reporting options. And, as I mentioned before, for the smaller lenders, there was a voice response system that was provided by SBA.

SBA ran the pilot for several months, and lenders were very pleased with this system. Some of the larger lenders, the ones with the largest portfolios, said that it used to take them up to nine days worth of research and sort of transcribing manual effort, to put these loan status reports together, say for portfolios of up to 1,000 loans or more. With this system, it was completely automated. So they were able to eliminate the nine days worth of manual labor. Obviously it was the right solution, because it combined the different reports, and it eliminated paper, manual data entry, and as I said, it saved both SBA and the lenders a lot of time and effort. Basically the lenders found that it was a very simple solution. They had free software for the pilot, they also had network services for the duration of the pilot, so it was one worry that SBA was able to take off their minds, for the pilot.

We ran some seminars for them, to teach them -- to provide some education and some training on EDI, on the use of the software provided by SBA. And as we also provided technical assistance, you know, they were available by phone to answer questions from these pilot lenders. So all of this made it a very simple solution for lenders. Some of the things we learned with running this pilot, talking to lenders and recruiting them to be part of the pilot was initially a problem.

You know, somehow people felt like EDI was this very difficult, very mystical thing, they didn't know anything about it, it was going to be difficult for them. But with training and some education, we were able to overcome the initial recruitment problem. We also found that with the lenders, I mean, lenders we are basically talking about commercial banks, here. They have a technical side of the house, and they have the SBA loan officer. And we have to get the two sides of the house together, get them to talk to each other, which we didn't understand we had to do, initially, but once we caught on we were pretty good at it.

We also found that lenders, who are going to reprogram internal systems to receive and send data automatically, it took them a little bit longer to come up and running. And so we understood that we had to provide them that lead time, so we had to give them advance notice, we had to give them a heads up, we had to provide them with technical specs as soon as possible, and give them up to three months to reprogram their internal systems. Not that it takes that long, but they often have other projects, other things that are in the queue. So you need to provide that sort of lead time for these lenders.

After the pilot project, we felt that the investment that we had made in educating training partners and providing technical assistance to them, was really valuable. That is what really persuaded these people to come up and running, and to do so in the time frame that SBA wanted. Finally, we found that testing is -- it takes a lot of time. We have to test, individually, with each lender. Okay, can you receive our message, can you send data back to us, can we receive what you are sending us? Is it what you think you are sending us? So that is sort of a test back and forth with dummy data, with acceptance test data takes a while. But without that, you can't be certain that the data that you are getting is clean, that it is going to hold up to your needs.

The first part of the lessons that we learned with the SBA pilot project, and Mark Carney from SBA's office of financial operations in Denver, is going to talk to you about some of the more recent initiatives that SBA has started in the EDI and EFT area.

MODERATOR KESTERMAN: Thank you, Meera.

MR. CARNEY: About three years ago, a colleague of mine came into my office, and he handed me an article from the Wall Street Journal, and it was one of the most significant things that I had seen in my federal career, because it was talking about their finance department. Ford had over 2,000 people in their accounts maintenance department. They had been able to bring that down to 250 people, and I looked at it, and I said, how did they do this? Clearly, the pressure's on me as a person and as a manager, to get things down, because no one wants to cut the programs, they are all looking for overhead.

MODERATOR KESTERMAN: Mark, excuse me, we are on the air.

Good afternoon to our viewers in the U.S. and around the world. Welcome to the first government-wide workshop on promising practices in federal credit programs. We are in the second day of a three-day program. We are televising live from GSA headquarters in Washington, D. C.

I'm Frank Kesterman, Department of the Treasury, moderator for this afternoon, and I'm joined by Tom Stanton of Johns Hopkins University. This session will focus on the electronic transmission of data, reporting and decision making, and payment and collection of funds. Our present speaker is Mark Carney from the Small Business Administration.

MR. CARNEY: Just to catch the folks that are coming on, up, I was talking about reading an article about three years ago, talking about the Ford Motor Company's finance department. They had been able to bring down the number of people in the accounts maintenance department from around 2,000 to around 200 people. I was very impressed by this, and I wanted to know more about how they were able to do this. I brought my folks into my office, my key managers, my computer people, my accounting people, my financial analysts, the specialists, and I said, how are these guys doing this?

We sat down and we found out that the main thing that Ford had done is they had put an infrastructure in, to be able to do things electronically. The other thing that they were able to do, is that they were able to bring their partners, their trading partners into this electronic environment. We said, well, how are we going to do that? Up to this point in time, I think that we were very good internally at managing a sea of paper. We had work flow control systems, we had machines that could track every piece of paper. We could put things on automatic and run them through.

We had systems that would help us do research if we had to find the loan number so that we could associate a payment with the borrower. All of this was paper driven. Clearly, within SBA, we didn't have the infrastructure to be able to affect what was happening with the Treasury Department. It was at that point when we said to ourselves, we need to go out of SBA, we need to talk to the Financial Management Service, and we need to find out what is going on with their environment, what is their vision.

And it was very gratifying. We realized, at that point, that there was a shared vision. There were people in the Treasury Department that had seen these types of things. The question was, how could SBA get itself in shape to be able to do electronic commerce, and how can the Treasury Department pull itself together to go into electronic commerce? Well, we had to realize some things. The first thing that we realized is that we were too focused on cash

flow, and not focused enough on data flow.

I'm not saying that cash flow is not important, it is very important. The question was, how do you attach your data to your cash? How do you get that information to you? I have 100 sites across the country, they want to know what got posted the night before. We spend a lot of time trying to figure out how we are going to do that. The other things that we looked at, is that we were doing some collections with electronic stuff, we were doing wires. We also found out that the addendum records were a problem.

I think anybody that is working with the Debt Collection Act of 1996 will tell you that those addendum records are not being handled well by the banking industry, and it needs to get improved. But, anyway, we looked at it, and we saw that the process was plunky. Yeah, I could get my money through Riggs Bank, into my Treasury accounts, but, somebody is sending me a 50-page listing of all the loans, that that one lump sum is associated to.

So I've got to get a technician to go through those pages of information and find out what piece of that lump sum is associated with it. At that point, we were like going, okay, this sounds good, let's say we do the wire transfer, but in reality, how are we getting this stuff posted? I guess the other part of it was, is that our deposits electronically, they weren't connected very well with our reporting, and so the other part of it, too, I just wanted to talk about going out, is that when we send things out, we mailed them, we found out that we were mailing stuff to the wrong place.

We found out that the participant didn't know what the check was for, so they are calling us up on the phone saying, you sent me money, I don't know what to do with it. In some cases, they sent it back to the Treasury Department, or they sent it back to us, because they didn't want to deal with it. Or, in other cases, it was just sent to the wrong department, so it was passed around the bank, from department to department until it finally ended up where it was going to be.

So, what did we do? Well, in our case, we didn't know a whole lot about EDI. So we started looking around, there was a magazine called EDI world, and I probably know about a third about EDI reading that magazine. The other thing is, we found out who the vendor was for the Department of Treasury. Through the Austin Finance Center, they had set up an EDI translator, it is called GEN TRAN, and this will allow you to get your stuff out, and attach addendum information to it.

I don't want to get too technical here, but there is a format called CTX, which is a corporate trade exchange. The great thing about corporate trade exchange, is that you can put 9,999 records in an addendum file, so that I can send one transaction for a million bucks, I can have 100 transactions related back to it. It comes in, and somebody can post their accounts and update where they are expecting, you know, a receivable from SBA and vice versa. The other process is called cash concentration or disbursement plus (CCD+). The problem with that is that for one amount of money, you can send one addendum record on it and for that one



transaction.

So I may be dealing with Colson, I think Meera was stating that they handle about 40 percent of our portfolio. It is kind of dumb for them to send me, you know, 5,000 separate ACH transactions. That is the issue. And so what we found out is that by using EDI, we can set up electronic mailboxes, so that we know that the information is going to where it needs to go. That was a big plus for us. The second thing here is, it gets us out of a paper environment. I don't know, I'm awash in a sea of paper. We did some process improvement stuff, and you know, we got 40 tons of paper out of our office, and we are all patting ourselves on the back. Someone came in and said "What are you talking about, you know, that is about three days worth of paper coming in this place." And we were saying, "okay." I guess the point is taken. You can do what you've got to do with a lot less people, you can get things done more accurately, you can get things more timely using EDI.

I just got a slide I'd like to have put up. And for those of you, I'm taking BPR 101, right now, so I got down the as is, and then after you've re-engineered, you go into your to be environment. And that is what I'm going to show you here. It is hard to see, but what it is saying is that right now in the electronic environment that we have, we have stuff that is coming in through the automated warehouse to us, we have stuff that is coming in on wires to us, and we have stuff that is coming through via electronic commerce.

What happens is that the key player in all this is the Cash Link System that the Department of Treasury runs. This is it. I mean, the infrastructure has been put in place. Electronic commerce is possible today, not tomorrow, not next week. The Treasury Department has put it in. And it is there, it is for us to use. Going through cash link, the information then gets -- you know, the money gets deposited in our accounts, and then we get past information, we go into the GOALS Reporting System, and we pull down information.

From that information we either get files from people, which is another thing you want to do EDI, you don't want to get 1,000 flat files from different participants. This allows everything to go through, it is called Remittance Express, and then we also have an ACH banker that we've set up. Anyway, the information will come through and then in some cases we will get it outside of the Treasury Department, and we will post to our accounts, automatically, without human intervention, of course, doing exception processing. The other part of it is that we can also balance our books with the Treasury Department, automatically. Our reconciliation process has dropped from 12,000 hours a month down to about two or three hundred.

Where are we going to go? That is the to be. As you can see, I've got it down from three to two. And the one is, our field offices, there is not too much we can do. We are setting up a lock box network, it should have about 550 million dollars flowing through it. The only way we are going to be able to get that information now is for our offices to input the per loan information. Everything else will be going through our electronic commerce network, and we are looking to have, hopefully at some point, about 260 million dollars a year flowing through there. We also plan on using a bank called First Union Bank of North Carolina, they will

be essentially routing the translated information to us. I'm trying not to be too technical, here. The way it is -- the bottom line here is, that for the first time, SBA will probably have cut back maybe 60 percent of the paper flow going into our retail lock box, and into our collection center in Denver, and it will be electronic, and we will be able to automatically know the money is in the account, roll what we are given into our accounting systems, post accounts.

Ninety-five percent of these accounts will be posted the day that the transaction occurs, which is pretty much unheard of, in most places. We will be able to do what we do with, probably, I'm thinking maybe 50 percent less people. And that is what I've got to say.

MODERATOR KESTERMAN: Mark, don't go away. Would you say just a few words about the pilot, how much money we brought in with the pilot, our joint pilot?

MR. CARNEY: Okay. At this point in time, our pilot is just getting started. We have signed up probably about 15 initial lenders on the guarantee fee pilot. And just to give you some back-up information, SBA now charges a fee, it is 50 basis points, and a 40 basis point fee, per year, to our lenders to have the deal on the books. We also charge an up front fee, when we do a guarantee. So fees are becoming very, very important, as we start to deal with the subsidy rate. At this point, right now, we are probably bringing in, under the fee system, in its mode right now, probably about a million dollars a month. But as I say, in the "to be" world, we hope that about 60 percent of our cash flow will be coming through EDI.

I want to thank Frank Kesterman, he is a good guy.

MODERATOR KESTERMAN: Thanks, Mark. Mark is Director of Financial Operations for the Small Business Administration in Denver, and he flew in to make this presentation. Thank you for making that special accommodation for this panel.

Our next speaker is Cyndy Zemitis, Director of System Technology, and Process Management Staff at the Department of Housing and Urban Development(HUD). She is going to explain to us paper processing status.

MS. ZEMITIS: Good afternoon. We at the Federal Housing Administration (FHA), ensure home loans. For the past 60 years, we have made it possible for many Americans to buy their first home. Although we have typically tried to serve those that are underserved by the private sector, we are also in competition with the private mortgage insurance companies.

Technology is key in meeting our increasing competition and customer demands. It has helped with increasing speed and responsiveness, quality and consistency, and productivity, reducing costs. Technology has truly allowed FHA to implement many paperless processes. For example, EDI, which you've just heard about, and I'll talk a little bit about, how

we've used EDI at FHA, ACH and also automated underwriting, these are just some of the examples. For the next few minutes, I want to just walk you through what it is like to get an FHA loan.

If you are an approved FHA lender, you contact us to get an FHA case number. In the past, you would need to write, and then it was a matter of phoning the local field office and requesting FHA case numbers. Now, the lender merely goes into his PC, and obtains the FHA case number. This helps us to track the origination process. We've also, once the case goes -- has been fully closed, they've been to the closing tables -- then the case has to be endorsed by our field office.

This process, too, has been skimmed down quite a bit. It used to be these heavy files the field office would have to review. That has been narrowed down too. We've worked with the industry and said, "What do we really need to see? We don't need to see all the documents we previously required."

We've broken that down, and now it is a matter of getting this information on disk. A new pilot program that we are real excited about that we are doing now, in the West, is allowing lenders to produce their own MIC, which is a Mortgage Insurance Certificate. Previously, once the case was endorsed, the field office would let the lender know it was endorsed, then the field office would have to print the MIC, mail it. Again, you know, paper, paper, paper. Now, what we are trying to let them do is let the lender, once they receive word that the case has been endorsed, then they would print the MIC.

Now, I've taken you, the case has been closed, it has been endorsed, now it is time for the lender to make payments to us. Again, they used to write out the check, mail it to us every month, or whatever the case may be. They'd write out the check and mail it to one of our lock boxes. Well, with a little nudge from Treasury, they were telling us, you better close those lock boxes. So we got those closed, and we now, as of April of this year, will not accept any more what we call "live checks". Everything must go through ACH, at this point.

It has helped tremendously, you cannot imagine. We had so many lost checks, and one thing we noticed during the furlough, there are always good things that come out of unfortunate situations. We found how many of these checks, around our department, because people didn't know, they would just address them to HUD, and somehow it would find its way to our office.

We are also in the process, right now, of developing a new collection system called the Single Family Premium Collection Sub-system, or we fondly refer to it as SFPCS. There are two modules to that, the up front and the periodic, and that relates to the type of premium that the lender has to pay. What is going to be nice about this system, it is going to show case level, payment detail, and reconciliation, and again, the three letters, EDI, will allow premiums coming in through EDI, when this comes up.

Again, I can't state again, and I'm sure you will hear it from other speakers, how EDI helps with timely response, the accurate information, and in our aspect, it has the lender being in control of the data that they are sending to us. We have already mandated EDI for some of our processes. One is the mortgage record change, and terminations. For any of you that have a home, that own a home, you know that your mortgage is going to be sold once, twice, or three times or more.

I've been told the average loan is sold three times in its life. As you can imagine, trying to keep this data up to date is just a nightmare. EDI, though, has helped, because again, the information comes in, it is clean, the systems are updated immediately. If there is any missing information, it is zapped right back to the lender, whoever sent it, and says, we need this additional information. So there are no mistakes. It is not like the paper forms are coming in, sitting there, waiting for someone to key it, and they may have a fat finger, some of the information. This has been a real life saver.

Same thing with the termination. We have band-aided this for our largest lenders, and we consider those the lenders that have over 20,000 loans in their portfolio. They had to start remitting, through EDI, in September. We've had pretty good success, we've had a few shakes, there were a few people that didn't think we were real serious about it, but they are finding out that we are definitely serious about the EDI mandate.

We are also mandating the claims. And this has helped a lot in the processing. As noted here, it is reducing the processing time from 10 days to three days. Currently, we have about 23 percent of the single family claims filed electronically, and we will have this mandated, for all sized lenders, again, by June of 1997. Another paperless application that we put in place is the electronic funds transfer. This has been implemented for the post-insurance development claims and also it is being implemented for the Title 1 claims.

We have also automated our single family homeowner refund. As you can see by the chart, in 1992, it took 120 plus days to get a homeowner's refund, which is outrageous. If you drop down, you will see in April of '96, we cut that down to 21 days. Now it is 10 days or less, which we think is fairly substantial. Currently, 57 percent of all of our homeowner refunds are fully automated, and only 22 percent have to be manually processed.

Other ways that we are trying to go paperless at FHA, the Internet. And I think that is really -- I personally believe that is the future, for us. I suggest you visit our home page, HUD has an outstanding home page, and FHA has a very active role in that. We communicate with our lenders, with our mortgagee letters. We have information on third party tracers, FOIA information, we are going to have more information about asset sales, and the list goes on and on. I'm very excited about it. What we are looking at in the future, we are going to be mandating ACH for the multi-family insurance premium collection. Up till now, I've only

talked basically on the single family house, but we are looking forward for multi-family.

We are also looking for EDI to go to the Title 1 claims, and FHA real connection -- real time connection, which means we would allow our lenders to access several of the FHA systems in originating loans. We have -- FHA alone, has 36 systems that we use on a daily basis. This would allow the lenders to be able to see what is there. Another thing that I'm very excited about, and this is in connection with the SFPCS collection system I mentioned earlier, we are going to -- we are exploring the possibility of putting the lenders' case portfolio on the internet.

Of course, there would be firewalls so other people could not see the cases. But it would be very valuable for the lenders to know exactly which cases we show that they are insuring, and that we are expecting premiums. When we talked with the industry about it, they are very excited. We are hoping that this will be a reality within the next year.

Thank you.

MODERATOR KESTERMAN: Thank you, Cyndy. Our next speaker is Martin Cooper, FDIC. Martin is a bank examiner, so you know that is serious business from what you heard this morning, from the FDIC and the Federal Reserve.

He is going to explain the new tool, ALERT.

MR. COOPER: My name is Martin Cooper, I'm an FDIC examiner in Baton Rouge, Louisiana. I'm here today to discuss with you the ALERT system, and how it relates to the examination process. ALERT is just one of many ways that the FDIC is using technology to improve the efficiency and effectiveness of the bank examination process. In order to show you this program, I'm going to have to give you a little background on what bank examiners do, and what process they go through in an examination. One of the most important functions that an examiner does, is to analyze the risk in a bank's loan portfolio.

Historically, the way examiners have done that, is that we will contact the bank a week ahead of time, and have them print out printed loan trials. These trials can range from, say, 30 pages up to 1,000 pages, depending on the complexity of the bank. An examiner would then take a highlighter and go through this loan trial, and highlight loans based on a pre-determined size, dollar value.

Once they've gone through this process, they would then go back through the loan trial and actually manually transcribe all the information from this loan trial, to a lined sheet. Actually, it is a piece of paper that examiners use to analyze the risk. This takes, historically, from several hours to a month or so, depending on the complexity of the bank. There are several advantages to using ALERT. One is it saves a tremendous amount of time. Two is, it allows the examiner to better analyze the risk in a loan portfolio.

Just to give you an example of the complexity that this program uses,

FDIC examines between 3,000 and 4,000 banks a year. They employ, roughly, 2,200 to 2,300 bank examiners. Now, neither one of these individuals have been trained on electronic data. Banks have never been asked for this information. And on the other hand, examiners have never asked for this information. So there is a learning curve on both sides of the equation. To make matters worse, there is over 400 different software vendors that provide software for banks.

So not only do we have to deal with the complexities and the learning equation, we also have to deal with the different software vendors. Essentially what the process is, is an examiner will walk into a bank, and he will ask for a electronic download file from the bank that contains the bank's data. He will go back, and he will slide this disk into his computer, and ALERT will actually read the information off the file, and the examiner will then manipulate the data, and print these line sheets. This takes the place of the manual transcription that had been done before.

What I'm going to do now, is to go down and hopefully show you a demonstration of the program. Now, this is an actual demonstration using a real bank file. The only exception is that all the names and everything have been changed, but this is the process that the examiner will actually have to go through. This is the ALERT program. It is a very user-friendly interface. It is basically divided up into four simple steps; set up new exam, scoping, management exam, and print reports.

I will quickly take you through each one of these things. The first section, which is set up new exam, it is broken down into a step process, so even examiners can follow it. The first thing an examiner will do is to reset the database. This would essentially clear all the information to make sure that he doesn't duplicate data from a previous exam. The second step would be to set up a new bank, and clicking on this, he can enter the bank information. Basically this is something that was put in there so we could track.

Step number three would be to import the data. Now, what this step is actually doing, is we are actually importing the bank's data into ALERT. You will notice we have three options up here on the top. These are primarily the main files that we do see. However, under custom import, you will see that we have various other file types that we can use, including Microsoft Access, Excel, Lotus, Paradox, pretty much most of your major applications.

For this demonstration we are going to use a Lotus file. We just went through the process of actually importing the loan's data into ALERT. The next step will be to map the data. Now, what mapping data does, essentially it is taking the loan fields that were imported from the bank, which you see across from the bottom, down here, we are going to tell ALERT what these fields mean.

There are several ways to do this. Number one is you can click on this

and pull down, and you will see that the names will pop down. It is a very user friendly interface. Once you've done an examination on a bank, or a vendor, a particular vendor, you can actually save the template, which is what I'll do here. Okay, we'll go ahead and map the data. What this does, it tells ALERT which fields in the bank database represents work that ALERT uses. Let's see if we can get through these, real quick. It will take just a second here.

All right, here is the information. This is all the bank information. You see, this particular bank had 26 million dollars in loans. This information will be used to tie back to the loan's general ledger, to make sure that all the loans were incorporated in the download. Once we've done that, then we will go to the next major section, which is scoping. What scoping does, is it allows examiners to -- I'll show you in just a second, let me get up here. It allows examiners to set a pre-defined percentage of the loan portfolio, or they can set a dollar amount.

Now, this was all -- historically it was done manually. It was a manual process and it was extremely time consuming. All you do is click a button here and you have your cut. Once we've done that, you've essentially done what we just did, went through in about 5 minutes what would have taken an examiner anywhere from several months to a month to do, depending on the complexity of a bank.

Once you've done that, you can print your reports, and I will show you what they look like. I don't have a printer, so I can't print them for you, but I can print it on the screen. This is the document that I referred to earlier, the line sheet. This is actually what examiners use to evaluate individual loans.

I think that is all I have, thank you.

MODERATOR KESTERMAN: We will have more questions on this subject when we get to the questions and answers. Thank you, Mark.

The next speaker is Pat Berbakos, Office of Research and Analysis, Office of Thrift Supervision, Department of Treasury. His subject is Electronic Filing of Financial Data.

MR. BERBAKOS: Thank you, Frank. First let me just say that I feel really fortunate to have the opportunity to address you here today, and talk to you about our program. Fortunately, it was successful.

That is not to say that we didn't run into any problems along the way, but hopefully my comments today may help you avoid some of the problems that we found as we converted to fully electronic filing of our data. A little background about the Office of Thrift Supervision (OTS), for those of you that are not familiar with the agency, we are a bureau of the Treasury Department, and we are the primary regulator of the Savings and Loan industry.

As a primary regulator of the Savings and Loan Industry, we have a need to obtain periodic financial information, which is one tool that we use to regulate our industry. Each calendar quarter we collect what we call the Thrift Financial Report, or TFR. For those of you more familiar with the banking industry, this is very similar to the commercial bank Call Report. The same type of data, relative to the balance sheet, income statement, and various operating information is provided on the TFR like the Call Report.

In 1992, the OTS developed the strategy of implementing a number of program changes that would facilitate thrift's financial reporting, reduce costs to the thrift industry, and also reduce those costs to the Office of Thrift Supervision. Some of the implementations or program changes that were made; we eliminated a number of data collections that we found had little value from the supervisory process standard. We took those reports that we felt provided value, and we wanted to continue and try to streamline those, and collect only the information that was relevant to the supervisory process, and our responsibility of regulating the industry.

The last step was, we wanted to move to total electronic filing of the data. We wanted to take advantage of system technology, incorporate that into our reporting process, and in a sense, hopefully facilitate electronic filing, data collection, editing, and processing. The decision was made in March of 1993, that reporting of the TFR would no longer be accepted in hard copy or diskette. All reports would have to be filed electronically.

Hard copy and diskette reporting was very costly to the agency. We had staff that were hired just for keypunching the data into our database system, as well as a number of our field offices that contracted with outside vendors, third parties, to collect the data and keypunch it into the database, as well. In fact, in some instances that cost us close to 400,000 dollars, annually, just to have the data input into the database system.

To facilitate our conversion to electronic filing, what we decided to do was to provide the software to the industry. We contracted with a single source to provide electronic filing software to the industry, to prepare, transmit, and also edit the data. We encouraged the industry to use the electronic filing software that we provided them, at no expense. But we didn't preclude them, if they so desired, to contract with a third party to electronically transmit it for them.

If, for whatever reason, they didn't feel comfortable using the software, and preparing the data that they could have a vendor provide that service for them. Our experience was interesting. What we found, even though in 1993, roughly 75 percent of the industry was utilizing some type of electronic filing software, 25 percent were not, or roughly 500 institutions. We assumed that when we converted to electronic filing we wouldn't run into too many difficulties.



As this first illustration shows, in December of 1992, when we still had a combination of electronic and hard copy filing, we basically had 34, we call them, non-responders. That is those institutions that didn't file the report on time. In March '93, you can see it is spiked up significantly to 397. What we found is that for those institutions that converted over from hard copy to electronic filing, they had difficulty in transmitting the data, setting things up.

Unfortunately, we didn't have the opportunity to provide hands-on training, it just didn't work out that way, where we could do that. So what we had to do, was staff at the time, had to basically walk a number of these institutions through the transmission process. As you can see, as time went on, through the corresponding quarters, the industry became more familiar with the software and by this time, June of 1996, the last reporting cycle, we had 16 non-responders. The other advantage of providing electronic software to the industry, was that we were able to incorporate into the software, the various edits that we use to validate the data.

When we initially provided the software, we had a handful of edits in the software. Not every edit that we use is to validate the data, simply because we wanted to take the opportunity to perform a zero base review of all the edits used and after completion of that effort, to incorporate all edits in the software. As you can see, in March of 1993, we had a significant number of what we call preliminary edit failures. Preliminary edit failures, or preliminary edits are those that we use to validate the data for our press conference information.

So the first cycle, we had a significant amount of errors. June, there was an initial spike of edit failure activity, and that was because we had a new report that was introduced in June of 1993, for small business loan data, and so we had a number of edit failures, there. But, again, as the industry became more and more familiar with the software, the various edit features available, the edit failure rates started to drop. You can see that the largest drop was in 1994, September, when there was a drop of 36 percent of the total edit failure rate.

What that is is a reflection of the completion of a zero based review of the edits. We eliminated a number of edits that provided little value, in terms of validating the data, and/or made changes to the various parameters of the edits that we continued to utilize. The next chart, I think, is a little more illustrative of the advantage of the electronic filing software, incorporating the edits. As you can see, looking at the past -- the June cycle over the past three years, in June of 1994, institutions averaged about 6.3 edit error, total edit errors. In June 1995, that was reduced greater than 50 percent, to only three edit errors, and in June of 1996, our most recent filing has dropped down to 2.4. Also, there has been a significant reduction in the number of preliminary edits that we use to validate our press conference data, from 1.9 in 1994, to below one for June of '95, in 1996. We really anticipate only marginal increases here. I think we probably achieved about as great an efficiency in terms of our edit process, with respect to edit failures that we initially received from the industry.

The interesting thing, during this whole process, is that the OTS was under a major initiative to reduce staff. We were under a serious budget crisis, as our industry

was experiencing financial difficulty.

We were looking at a number of ways that we could reduce the costs associated with this process. As a result of taking advantage of this technology, we were able to reduce these by 50 percent, that was dedicated to this function. In 1993 we had approximately 39 FTE's dedicated to the edit validation function, and this year we were able to reduce that number to 19. Accumulate the savings over the last two years, with the various steps that we've undertaken, to reduce the reporting burden, the cumulative savings is about 20 million dollars. That is about 5 million dollars to the OTS over the last three and a half years, and 15 million dollars in savings for the industry. Some of the lessons that we learned, that I wanted to walk you through, so that hopefully you will avoid some of the pitfalls or problems that we experienced, are: One, I don't think you can communicate enough with your customer base, out there.

You need to correspond as much as possible with them, to try to walk them through the process. At a minimum, you need to identify the type of equipment that will be necessary in order to run the software, such as a 286 with a hard drive, etcetera. You need to identify the types of modem and speed, how to dial-out telephone numbers for assistance. It is also very important that you provide them with technical assistance, technical support, telephone numbers.

The report preparer should have manuals. What we found, we provided manuals to all the institutions, but a lot of times we send information to the institution, and for whatever reason it doesn't make it down to that report preparer at the institution, who really needs that manual in order to transmit the data. You also need to train your staff. As much as you may provide telephone numbers for the software vendor that is providing the software, what we found is our staff tended to be the greater help line support than the vendor.

I think simply because the report preparers at the institution, they were familiar with our analysts, they felt comfortable calling them, and having them walk through the process. So it is very important that your staff be trained to help them as they convert over to electronic filing. We are also told that they like a graphic display of when they transmit the data. I think one of our vendors was using what was like a telephone pole, and the line going through from one pole to the next, and you could see the data being transmitted, so it was visually there, when the data was received at the institution.

That is very important that they know that when they hit that button to send it, that you have, in fact, received it. If at all possible, which we weren't able to do, it would be helpful to run a test transmission for each institution. I think that if we had it to do over again, and had the time, that was the problem, it would have been really helpful to be able to run a test transmission and walk everybody through before we actually went live. Also, I would offer hands-on training, to the extent that it is possible, to provide training to those institutions out

there that may not be familiar with electronic filing software, and walk them through the entire process.

Thank you.

MODERATOR KESTERMAN: Thanks, Patrick. Before you go, I have a question about the cost of software. Now, obviously with all the savings that you've accrued, the cost of software is not an issue to you, but there are agencies that have thought hard about, can they provide software to all their thousands of lenders. Can you tell us something about your initial decision-making with respect to providing the software, and how much that cost?

MR. BERBAKOS: Sure. What we did, as I mentioned, we contracted with the sole source provider of the software, so we actually developed a request for a proposal, and solicited vendors to provide bids for the contract. Our contract, the way the pricing mechanism was originally structured, was a unit price, based on per software, provided to the industry. We found that based on the pricing that we received for the contract, that it was relatively inexpensive for our industry, for our thrift financial report, we do have other software packages for other reports that also collect. I think the total cost was about 45 dollars per diskette, for each institution, plus there was another 5 dollar fee, on top of that, for mailing. So it was relatively inexpensive in the long run.

I think if you go on the open market today, for software, for the commercial banking industry, it may range from around two to 400 dollars, depending on what version you purchase. I think the key there is by providing the software, we thought that it would help to facilitate the conversion to electronic filing, make it easier for the institutions to come on board with electronic filing, rather than have to go out and purchase the software themselves.

MODERATOR KESTERMAN: Very good. We are going to have to go into the question and answer period, for a while. And we have two other speakers this afternoon. If they are in the audience, we can probably take you sooner rather than later. So let's start asking these folks questions. Well, I have one to ask SBA --

PARTICIPANT: I'm asking whether it is reasonable to go to weekly reporting with that infrastructure set up for reporting for financials to --

MR. BERBAKOS: I clearly think that there are advantages, simply because if you could take the software that you are providing to transmit this financial data, and build in the edits, that is where the real savings is. What we found is, one of the charts that I showed up there, is that by incorporating the edits used to validate the data, into the software, what in effect happens, is you have the institution doing your first edit, your first round of editing. The data comes through in a much better quality than without utilizing software and incorporating edits.

The fact that it is weekly or monthly, quarterly, or whatever, I don't think that it makes a difference. We also have a monthly data collection that we provide software for, and build the edits in there as well. I think in every instance, we were able to incorporate all edits into the software, we found tremendous advantages in data quality.

MODERATOR KESTERMAN: Okay, my question to both the speakers from HUD and SBA is, I see an enormous amount of energy and work going on in your two agencies, in electronic processing. And I'm wondering if you could give us a feel of how many FTE's, how many contract dollars you are applying against this tremendous change in your business processes.

MR. CARNEY: I'll let HUD go first.

MS. ZEMITIS: I don't know those figures. We are using quite a few contractors. I'll have to get back to you.

MODERATOR KESTERMAN: On order of magnitude, do you think you get a tremendous amount of work accomplished for what you are expending in terms of energy and dollars?

MS. ZEMITIS: Yes, most definitely.

MODERATOR KESTERMAN: You need more money to get more work done?

MS. ZEMITIS: Right. And the thing, too, we are facing, just like everyone else, you know, cutbacks of staff and so forth. And, I mean, we've been given our orders from the Hill or whatever, how many people we have to cut. And the systems that we are developing, the changes that we are making through the electronic processes, will allow us to do our job well, with less people, to be quite honest.

MR. CARNEY: We had about 180 people in the chief financial officers group about two years ago, and now we are down to about 118. Out where I am, in Denver, my staff has stayed about the same, I have about 102 people. The only interesting thing that has happened over the last six years, is our workload has increased by over 100 percent. Clearly, if we didn't have these electronic mechanisms to rely on, we'd be dead meat. One of the things that is very interesting, in terms of the cost, we talked about the distribution of software. When we looked at the EGLSS system, we had 8,000 participants, and to do the ramp up, which is what they call it, to bring these people on line, was formidable.

When we look at the guaranteed fee, we are also going to be looking at some other things that we do with our participants, but we figured that there had to be a way to do it that was cheaper. Meera and her folks at Price Waterhouse came up with a way to imbed the EDI transaction set in a CTX file, which is standard banking format, or will be in the next coming years. And because we are able to imbed the transaction set in the file, there is no ramp up involved, because they should be able to do that in the first place.

We, on the other end, had to invest in translator software, and that ran us about 42,000 dollars. In terms of the work that we are doing to go electronic, I mean, we re-deployed resources that we had, we haven't added any extra. I called Frank a good man because his -- the Treasury Department has been funding Price Waterhouse, who has been a very powerful ally to us, in trying to do this. I mean, this is a great partnership, and we are trying to do this as smart as we can.

MODERATOR STANTON: I'd like to ask a question, if I might, having to do with implementation. Basically what will it take, Mark, to get thousands of lenders to convert? I was very interested, particularly in the OTS presentation, in the sense that -- and also HUD, which started with the big lenders and then moved downward. But if I heard Meera's presentation right, simply telling them to do it isn't enough.

You've got all sorts of internal problems, and what I'm wondering is, what happens if you announce that two years from now, preferred lenders, in other words, in order to get bennies, or low document lenders, or somebody that wants something out of the process, in fact has to be electronic to get it. How would that work?

MR. CARNEY: Quite frankly, we went out and we spoke to a lot of our participants. And there is no profit in changing the process, in many cases, for them. We have to be able to tell them why this is a good thing to do. In a lot of cases, and that is what I was alluding to, with even the Debt Collection Act, right now a lot of banks, when you send the transaction, the ACH transaction, the addendum information falls to the floor, in the off-center at the bank; they don't pass that on to the person receiving the money.

What they say is, well, you go figure it out, or you look on your bank statement in the following month, and you figure out what it is for. We said, "Why are you doing that?" and they are saying, "There is no profit in it, for us." We are grappling right now, I was -- in fact, I think in Price Waterhouse, they gave me a couple of examples of where agencies have modified agreements with their participants. They have asked SBA to consider to do the same thing and I went to our borrow and lender service people and said, what is the chance of modifying this participant agreement, the guarantee agreement we have to make these folks go ahead and do electronic business with us.

They were receptive to it, but at the same time, the politics of sitting there and telling someone that you are going to pay us 50 basis points for every loan that you have on the book, every year, and we will raise the fees to your business. I mean, there is a sensitivity of how much you are going to ask from your partners and your participants, because we are also asking them to start carrying some weight, lifting the weight for the agency, in a lot of areas. I think we are going to go there, I think that DCA was a good start on the disbursement side, now the collection side has to catch up with it.

MODERATOR STANTON: Is that how the experiences go, that your lenders don't get the same kind of benefit you, HUD, gets from converting to electronic? I mean, I would think it would be a symmetrical situation where they, in fact, could reduce their workload on the sending end.

MS. ZEMITIS: They definitely do, and this is -- we've had the benefit, we work very closely with the mortgage banker's association, in a partnership, in developing the EDI transaction sets that are developed. I think there are 26 working groups working, right now and it is great. I just attended my first EDI MBA working group, about three weeks ago, and I had lenders from all over the country sitting down, and really the nitty gritty, how are we transmitting this information, what information has to be transmitted and so forth.

So with MBA's backing, it has made it easier, and actually then we are helping too, with the lenders. There is also another organization which you may or may not be familiar with, called MERS, it is the Mortgage Electronic Registration System. Where they will be registering, there will be a universal loan number for every single kind of mortgage loan. EDI is really the driving force behind that. So the MERS corporation was very happy when they saw HUD going forward and mandating EDI, because that, again, forces the lender to get in. There is a cost involved, there is no doubt, but it is the cost of business that will be paid off later on, they'll see it. They may not see it right away, but you've got to spend money in order to do business.

MS. RAMACHANDRAN: To just sort of add to that comment. When we were doing the EGLSS Project, we assisted SBA in doing a cost benefit analysis. Now, yes, in order to ramp up, it is a big effort, and an agency should not underestimate the effort, particularly if you are going to be bringing thousands of trading partners on board. But in the cost benefit we do for SBA, the net cost savings over a period of 10 years, was something like 50 million plus.

So if you have to spend two, three, 400,000 dollars in year one, in order to realize that kind of a net cost savings over a period of time, I think numbers speak for themselves.

MODERATOR KESTERMAN: You can't not do it. Whatever the cost is, it is small in the long run.

MS. RAMACHANDRAN: Even though when you look at the cost in and of itself, it appears to be formidable, just to start with, it pays off.

MODERATOR KESTERMAN: Seeing Meera down here reminds me, we just finished a project that I'd like to tell you a little bit about, then I'm going to ask Meera to expand on it. We've done a pilot project within the Financial Management Service to bring EDI into the determining process, the electronic commerce. We also developed an EDI how-to guidebook, which deals with the procurement process, guaranteed loan management, and payments to collections.

This is a book that is right off the presses. We are going to print probably 1,000 copies, and my goodness, here is one that showed up. We don't have these for everyone, but they are going like hotcakes. But when we get the printing completed, you can call my office and we will make them available to you. With that as an intro, I'm going to ask Meera to explain a little bit about the pilot that we did in FMS.

MS. RAMACHANDRAN: The pilot that FMS did, was on the procurement side, as a lot of agencies have attempted to start electronic commerce procedures; that is conducting all of their procurement procedures using EDI and EFT. The interesting thing about the FMS effort was that they went through a couple of months of analysis, up front. They looked at the procurement process all the way from the beginning of the process and the requisitions, through to payment of vendors, including receipt of goods, everything, also, acknowledgement of services rendered, and conducting the whole process through EDI, and paying vendors through EFT, a completely seamless process.

FMS developed a model for a complete electronic commerce process, which includes everything from EDI to bar coding of receipts, evaluated receipt settlement, so a model that can be implemented over a period of time. Then FMS conducted a short pilot with four, five vendors, just to prove that it could be done, sending out RFQ's, receiving quotes, etcetera. And I think we've got three or four vendors on board, now.

MODERATOR KESTERMAN: Very early on in the whole process since the beginning, probably three years later you may hear in another workshop a success story, hopefully. So we are starting down the electronic commerce path in FMS.

We have time, so I'm going to go back to Martin. We had a very poor image up here, and I don't think the audience could see what he was talking about. Since Martin came all the way from Louisiana, I want to give him another chance to explain what ALERT does and how it is used.

MR. COOPER: Yeah, sure. Essentially ALERT, when we examine banks, we select a sample of loans to review. What ALERT is, is a tool, that helps examiners in this selection process. One of the ways, there is actually two benefits of ALERT. One of them is that obviously time savings would be involved from that manual transcription process. That is

going to save, in the long run, thousands and thousands of man-hours.

One of the most primary benefits is that it allows the examiner to target in on certain areas of a bank's loan portfolio, that may be high risk. To give you an example, historically most of the risk in loan portfolios has been in the commercial loan portfolios. You can go into sectors, specifically, let's say commercial loans, hotel loans. By using ALERT, you can actually target in on those particular loans. Whereas, historically, you couldn't do that, all you could do is basically take a cut of say a dollar volume of a certain type of loan, and look at it from that perspective.

MODERATOR STANTON: I'm always curious with these structures, where you've got what we would like to call information asymmetries. How do you deal with the quality of the information? I guess the fundamental question is, is the quality of information worse if you are looking at something a bank has made an electronic record of, than if you are looking at the loan file itself, in order to make a judgement about the quality of the loan?

MR. COOPER: Well, actually, let me take it a step back. ALERT doesn't necessarily, on this particular line sheet that I referred to, does not put all the information, we only put select information. For instance, the information that is maintained in the loan's portfolio, for instance, the loan balances, the note dates. All that information is then verified by looking at the loan files, so you are not actually substituting what you would be doing, it is more of putting ALERT so you can check it off.

MODERATOR STANTON: So it is organizing the information more than anything else?

MR. COOPER: That is correct.

MODERATOR KESTERMAN: How about it, audience, any questions for our EDI, electronic information experts up here?

Okay. Then we are going to go on break for 10 minutes, and we will reconvene with our next two speakers. So please don't go too far, and please come back and we will tell you what is next. Thank you.

(Whereupon, the above-entitled matter went off the record at 2:57 p.m. and went back on the record at 3:34 p.m.)

MODERATOR KESTERMAN: Hello. I have to make an announcement for our television audience, and that is that we will be running a film on electronic commerce and EDI for the remaining part of this broadcast.

We will be back on the air tomorrow at 11:30 to 12:30, and 2 to 3:30



p.m. We hope to see you then. Good day.

Friends and colleagues. We have our last two speakers, they showed up and they are ready to proceed. We are going to start later tomorrow morning, around 9:30. The two speakers are really, you might say, worlds apart in what they do. Who knows? They might find things of interest of what each other is doing.

We have two different subjects that will be treated by people who are experts in their own fields. Our first speaker is Kathy Kuhl-Inclan, Assistant Inspector General for Audit from the Department of Housing and Urban Development (HUD), and she is going to explain what they've been doing in "Operation Safe Home." Our next speaker after that, which I'll introduce again, is Jeff Miller, Vice President of the Export-Import Bank, and he is going to discuss their default policy.

MS. KUHL-INCLAN: With apologies to anybody who may be from Los Angeles, but you know, in about 25 minutes, I just moved here from Atlanta, and so the Braves start about 4 o'clock today. And I thought, is there any way that I can wear headphones while I'm either listening or doing this? But I can't contain my enthusiasm, so I just left the headphones at home and I'll spend my time with you. I wanted to tell you that I'm from Atlanta and recently moved to Washington to be the Assistant Inspector General.

In Atlanta I was responsible for the Office of Audit of HUD, for the district in the southeast. And Operation Safe Home was something that we really came to absolutely adore. It was one of the most favorite things we had done in the Office of Audit, in terms of actually getting results, and dealing with program staff in a collaborative manner, as opposed to one being on one side of the table, and one being on the other side.

Operation Safe Home was the name that we gave something that was announced by the Vice President back in 1994. It was an effort with the Department of Justice, with the Department of Treasury, and with the Department of HUD. It was three-faceted. One was to deal with violent crime in public housing, the other part was to deal with white collar crime in public housing, and then the part that I want to speak to you a little bit about, which was equity skimming in multi-family housing.

Now, violent crime in public housing was something that the investigators were going to handle. We just didn't want to be involved with that. We worked with the investigators on white collar crime, but the issue of equity skimming in multi-family projects was something that the audit side could tackle. It was something that we had been dealing with for a long time and in case you are not quite sure what equity skimming is, it is just a situation where we have many, many, many multi-family projects that are insured by HUD, and the owners

are required to make mortgage payments, plain and simple.

If they do not make their mortgage payments in favor of taking the money for themselves for ineligible costs or for distributions or advances, it is called equity skimming. When we started looking at the vulnerability we had in this area, we realized it was huge, and we weren't being very good, we weren't very successful at all in combating it. We did a lot of research, and we found that there was really two laws on the books dealing with it. One of them was criminal, and one of them was civil. The issue of a civil law was, it is a very, very, very simple law. And it just says, multi-family owner, multi-family management, agent, if you have a HUD insured project, and you choose to take money out of that project when it was in a non-surplus cash situation, or if you choose to take money from that project for ineligible purposes, based on a contract you signed, the regulatory agreement, you are subject to double damages.

You don't even have to show harm to the government. We just have to show that they took the money in violation of the contract that they signed. Well, we never used that law very much. It had been on the books since 1988, and we thought, by gosh, double damages, the law also says we can get our audit fees back, we can get the legal fees back, we thought we were in heaven. Because the investigators were going off in Operation Safe Home in an area of doing violent crime, the audit side had tended to stay out of the justice arena. We didn't go to the U.S. Attorneys, at all, we let the investigators do it.

As investigators tend to do, they were interested in the issue of criminal enforcement. And the civil law wasn't something that they were very much dealing with, but this was a very simple, simple, simple law. So our inspector general, Susan Gaffney said, auditors, we are going to give you the responsibility of going to the U.S. Attorney, which is really quite unique in the Inspector General's arena. The idea of the auditors actually making presentations to the U.S. Attorneys, is something that is not really very germane. There was a little bit of territorial discussion between investigations.

Then, when we came to realize that we were better -- the audit side could better make the case to the civil side, we sort of took that role. What we did was that we would establish that equity skimming had occurred. We would do an audit. We didn't even necessarily have to issue an audit report, but we did establish that there was this regulatory agreement, they violated it, what the double damages were. We'd put together a package, and we'd go meet with the U.S. Attorney. We would sit down with this U.S. Attorney, in most cases they didn't even know the law. They were unfamiliar with it, because HUD had never tried to

pursue it, but because of Operation Safe Home, and the fact that Janet Reno had said, we will be a part of this, we had their interest, at least their ear at first.

We would have to explain to them the situation, and we'd give them the law, and we'd say, again, read this law, it is really simple, we think we have the facts, and we dealt only in black and white issues. If the issue was grey, we'd say, no, we don't want to deal with that. We want to prove to this U.S. Attorney that this owner took the money from the project in violation of the law, absolutely, no questions asked. So as we started doing these presentations, and we started getting good at it, we realized that it was even easier, but we needed help. So the part that became the most fun to me was the collaborative idea. We needed the Office of Housing, which is our program side, they, in essence were the client to the U.S. Attorney, because they were the ones that insured the mortgages for these projects. So we would do the audit work, the Office of Housing would go with us, and then we also knew that the U.S. Attorneys were very, very busy, and they didn't have time to write the legal briefs, they didn't have time to write the demand letters, and we could get their interest, if we could say, we'll help you write those briefs, and we'll help you write the demand letters, and we will help you write whatever you need to write.

Of course, the lawyers, I mean, the auditors couldn't do that, so we brought the program lawyers in, as well. We became collaborative, we'd work together, we'd set out the issues, the lawyers would do the legalese, housing would agree with us, and they would provide some background as to how this happened, and what their involvement would be. We'd march into the U.S. Attorney and give them this presentation, and as a rule, we've been very, very successful in getting them to take our cases. And it is amazing. When we issue an audit report for multi-family project, and it is a set of findings, and most of you may have dealt with findings, they kind of just go to sleep and say, yeah, yeah, HUD has never done anything, we don't really care, we are going to push this process out as far as it can go. But, when they got a letter from the U.S. Attorney that said, you -- Housing and Urban Development -- have come to me, and they have told me that you have violated the regulatory agreement, under this civil law, very simple civil law, you have violated, and you withdrew, let's say, 100,000 dollars in ineligible costs, and because of that you now owe the Federal Government 200,000 dollars, plus added fees, plus legal fees, they didn't withdraw.

They were willing to come to the table, they were willing to call the U.S. Attorney and say, I think we need to talk about this. And so we haven't gone to court -- we've gone to court maybe once. As a rule, we don't even have to go to court. The letter from the U.S. Attorney, the resulting negotiations, the resulting discussions, have brought owners back to the table, and they are saying, well, if we don't go to court, would you take X amount of money?

We usually end up making a good settlement. And the way we've tried

to do it in terms of maybe putting a little extra bite into it is saying, we'll take this settlement, but you also owe us the audit fees. Well, in the Federal Government, audit fees are usually fairly high, compared to what private practice may be, because our audit effort is a lot longer. And so we have gotten as much as 120,000 dollars in audit fees, in addition to the equity skimming amounts that have been negotiated out.

In the end, this effort of the audit side developing a civil referral and taking it to the civil attorneys, without involving the criminal side in the case, has been extremely successful. As I said, it has taken us from a situation where we are antagonists with the Office of Housing, which has tended to be where we were, they are the ones that had to resolve out audit reports. It has taken them back around to the table, and we have negotiated with the owners. In many cases, the Office of Counsel and the Office of Housing, and the Office of Audit, will go outside with the U.S. Attorney, and talk about the settlement offer that has been offered by the particular owner, and we work together, and we feel wonderful when we get this check for 900,000 dollars. I have, in fact, actually gotten the check for 900,000 dollars from an owner. We have gotten people to say, we are tired of dealing with HUD, we are going to refinance our loan, go to the private market, which is fine, too. We don't care. The people that we consider the bad actors are now out of our program.

We have tried to publicize our results through the various technical magazines, and various newspapers, or whoever we can get interested in it, because we really wanted Operation Safe Home to be a deterrent, as well. We wanted the owners to realize that they had a contractual obligation with the government, and weren't entitled to these cash proceeds, there was some teeth that we were going to use, and we were, in fact, going after them. The thing is, it is not just an issue of them taking the cash, but what tends to happen, we are in the business of housing people who are in low and moderate income. And when the owners take the money from the project, the units suffer. They don't get painted, they don't get roofed, the utilities sometimes don't get paid, the tenants are not living under the conditions that they are supposed to be living under, and the owners are getting richer and richer.

So we felt like we needed the deterrent, not only to tell the owners that we were serious about enforcing the laws on the books, and expecting them to meet the intent of the regulatory agreement they signed, but also we wanted to protect our tenants better. We thought we had -- we do have an obligation to give them the best housing that we are paying for and so we use that, also, as a positive effect.

The other part of that, is in terms of the civil issue, there is a criminal statute on the books, as well, for equity skimming but, as you know, in criminal cases, you have to prove beyond a reasonable doubt, whereas on the civil side it is the preponderance of evidence.

It is very difficult for us to get a U.S. Attorney who is interested in the criminal case, because it doesn't have any jury appeal, it is very complicated, sometimes HUD made decisions that weren't always in the best interest.

With the case of the civil side, the law was very, very, very specific, very, very, very easy. I mean, we were surprised at how clear it was, how there wasn't any grey, it just said, if you take the money you have to pay it back, double time. So we thought that we were very, very proud. We've had 42 million dollars in settlements and judgements in about 60 cases. We have had 10 criminal convictions, which included about 215 thousand dollars in restitution. There are a couple of U.S. Attorneys across the country who are interested in criminal cases. But one case that I specifically had in Atlanta was a criminal case, where the owner just phoned up invoices. He was actually billing -- he would say that the project was buying lumber, and in fact they were paying it back to him, and then he would take the money out of the money that he was receiving, he bought a Porsche, and some beautiful carousels for his office.

We could prove that he not only took the money, but he intended to make himself rich, and so this man is going to end up going to jail, hopefully. But most of the time it is not quite that simple. Right now we have 68 cases that are all in the hopper with the U.S. Attorneys, 44 are civil, 12 are criminal, and then there are 12 that are a combination of civil and criminal, which means we have to kind of run parallel proceedings. What I wanted to impart upon you today is that we feel like we've taken, we've gone away from the idea of always having to issue an audit report.

Using the laws and the staff and the knowledge available to us through this one civil law, which allows the auditors to go straight to the U.S. Attorneys, present our case, get convictions and prove to our clients that yes, we do in fact intend to make you meet the commitment that you signed for, and that if you don't, there are consequences to be paid.

MODERATOR KESTERMAN: Let's take questions, individually, since these subjects are so different. Any questions? I'll start the first question. Kathy, I think I heard you say that the owners weren't making mortgage payments, is that correct?

MS. KUHLMAN: If they choose not to make mortgage payments. In other words, if the mortgage goes into default, and they choose instead, to use the proceeds from the rent for their own personal gain, that is considered equity skimming.

MODERATOR KESTERMAN: If they go into default, what is keeping the lender from foreclosing?

MS. KUHLMAN: The lender does, that is the taxpayer's issue -- the lender does foreclose, and because the mortgage was insured, HUD pays off the mortgage. And so we end up -- the mortgage is insured by HUD, goes into default, sometimes it is

foreclosed, sometimes HUD takes possession, but in the end the taxpayers end up taking the bite for the fact that the owners are getting rich.

MODERATOR KESTERMAN: So there isn't an incentive for the owner to make the mortgage payment, unless you pursue them?

MS. KUHL-INCLAN: Right. And it was widely known in the industry that we would do audit reports, but we never got much further than that. It was just a paper process.

PARTICIPANT: I'm from OMB, and I'm the housing program examiner. And I want to know if the '97 Probation Bill -- I wonder if you are familiar with those at all?

MS. KUHL-INCLAN: No, I can't say that I am. If the law is -- we've had some discussions with Agriculture, I believe, and I believe, we've even kind of walked them through some of this, but I don't have any more knowledge than that.

PARTICIPANT: Where is the law that you are dealing with?

MS. KUHL-INCLAN: It is 1750Z-4A.

PARTICIPANT: Thanks.

MODERATOR KESTERMAN: Questions?

PARTICIPANT: The law you used a couple of years ago, the Department of Education, for the Guaranteed Loan Program, on the civil side, I think is a very, very, important factor. Do you think that this is something where the Justice Department can do the loan program, through your experience -- do they see this as -- organized in such a way as to be useful for other agencies to use?

MS. KUHL-INCLAN: Well, I can tell you that as they've set up their Affirmative Civil Enforcement (ACE) Offices, throughout the country, and there have been more and more developed, they have come to us and asked us for our cases, because they see it as a real opportunity to do some collections. In all honesty, they have the support part too, where they are supposed to be, you know, proving that they have recovered X amount of money, and they found this to be a beneficial, and relatively easy way. I mean, there are lots of negotiations.

So it is a long way of saying, yes, I do. As long as there is a law that they can work under, they view it as something that is easily done, and as long as they've got a kind of a partnership with the agency, and the assistance that they need, they are more than willing to take the cases. In many jurisdictions, as the ACE Divisions have been developed, they

developed a specific section dealing with civil enforcement, they want our cases. It is just amazing that we've -- it has kind of turned around from begging them, to them begging us, "Please give us some more cases."

MODERATOR STANTON: I've got a question. We heard the other day an excellent presentation on the SWAT program in multi-family. And one of the key issues for SWAT is case selection. Have you been able to develop a fairly efficient way of finding the cases, and sort of winnowing them quickly so that you can sort of say, yeah, we can demonstrate this? And what is your sense of the quality of information that is coming in to the IG to figure out what you want to act on?

MS. KUHL-INCLAN: To answer your question, yes. We have sort of developed a profile, and now we are teaching the program side to also identify the profile. The law doesn't require that we show harm to the government. However, the U.S. Attorneys are very hesitant to take a case where there hasn't been any harm.

What I mean by that is, if the mortgage is current, and there has been no loss to the government, in other words, they are not as willing to take it, even if the owners may have taken out money that they weren't entitled to, as long as they kept their mortgage current, we have to show some other effect. That is our first criteria. We look to see if it is in a non-surplus cash situation, it is a calculation done by the CPA's at the end of the year, and then if they are in that situation, they can't take any money. We try very hard to find some negative effect on the government. Some harm that has resulted from this.

MODERATOR KESTERMAN: -- seems to indicate about a quarter of HUD's multi-family program can't even service its mortgage. You know, you write the mortgage down to zero and these things are still not financially viable. Is that essentially the pool you are talking about?

MS. KUHL-INCLAN: Well, we have to look at it in terms of that there may be other issues of why that mortgage isn't viable. I mean, if it is just a poor rental market, if - - we are looking for absolute evidence that the owner took money from the project, not that there are other circumstances which caused that project to be in a non-surplus cash situation.

MODERATOR STANTON: I understand. How do you bring those cases to you? Is it basically training, you are sort of getting the HUD staff --

MS. KUHL-INCLAN: We ask the program staff to give us them, or else we -- some of our best cases have come just from figuring the financial statements. I mean,

the CPA's will disclose these ineligible disbursements.

It is not always picked upon when the program side looks at the financial statements. So we do what we call follow reviews, and we go through the financial statements and look at those financial statements. Then, the program people who have been dealing with the owners, have a sense of owners who may have been doing things, and they have indicators themselves. So we take it from leads from the program side, and from our own review of the financial statements, some proactive efforts.

We've had a couple of cases where even the U.S. Attorneys come to us, because they want us to do it, because it is a drug-infested area, and they have to deal with all facets. I mean, they'll go in and do a drug sweep, and then they'll expect the owners to take a more active stance. So they've asked us to look for equity skimming, because they've not maintained the projects. And, if they are taking money instead of maintaining the projects, then it sort of breeds an environment that is not proper for the tenants. And so they've asked us to help them, you know, they'll deal with the drug issues, and we'll go after the owner saying, you owe X number of dollars.

In one particular case, instead of taking the money, the U.S. Attorney had us -- had the owners escrow the money to be used only for maintaining the units, and doing the maintenance that should have been done a long time ago. He told them he would not prosecute them, as long as they brought the units back up to standard, but he has held that over them. They signed the agreement that if for any reason that money is not used properly, and the units aren't brought back up to standard, they are subject to the double damages, and it was about a million dollars.

That is one lead and usually we do not rely on the financial statements to make our case. We do a lot of work after we get there. But in a lot of cases there is enough indication in those financial statements, in the footnotes, or the calculations of surplus cash, or whatever, that we can pretty much see that this may be a candidate, and then we will go out and actually do a review of the books and records, and do as much work as we think we have to do to establish whether it is an equity skimming case, and whether it is a good case for the U.S. Attorney, so it is just one way.

MODERATOR STANTON: Do you have an effective course of action if somebody has kept really bad records?

MS. KUHLMAN: Well, right now -- yeah, they are supposed to



maintain books and records. And because we have gotten -- the department has gotten much more proactive in enforcement, if those financial statements aren't sent in, or if the books and records aren't maintained, it is an automatic 2,500 dollar penalty.

It escalates after that if they continue year after year not to provide the financial statements, but that didn't happen before. It is because of our push to not punish the owners, but to just make them realize that they have a contractual obligation that has some teeth.

MODERATOR STANTON: Have you had any political backlash?

MS. KUHL-INCLAN: No, we really haven't, because at least so far, I mean, it was a vice presidential announcement, we got the cooperation of three different departments. Right now we haven't had any.

MODERATOR KESTERMAN: There are no further questions. Kathy, is there anything you want to put on the record, because we have a transcript here, and this will be the permanent record of the conference, that you think people ought to know about, that you haven't mentioned?

MS. KUHL-INCLAN: No, I don't have anything to add.

MODERATOR KESTERMAN: Thank you very much.

MR. MILLER: Good afternoon. It is a rough week, closing the books for the Government, the IMF, the Peace Talks. That is not bad, it is those limousines on the streets that are bothering me. I drive in, and I think I'm in the wrong business, I think I should be in the limousine service.

Anyway, as Frank said, I'm Jeff Miller, the Vice President of Claims and Recovery at Eximbank. We are the division of Eximbank that is responsible for problem loans, and taking over in case of defaulted loans.

Just to give a quick background for some of you, the Export-Import Bank, as you know, supports by giving loans or guaranteeing loans, or insuring trade financing transactions for foreign borrowers, in order to buy U.S. goods and services.

The focus is U.S. goods and services. Our customer is the exporting community, and we'd like to think we make a difference, and be there when deals that couldn't happen by the private sector, that need to go on, and exports need to sustain and or create jobs in the United States. However, we have a mandate, and that is a reasonable assurance of repayment. We are concerned, because we have our customers, the U.S. exporters, but our Board of Directors is basically the U.S. taxpayers. So after the debt crisis of the 1980s, we felt that we were in an awkward situation, because we have exporters who want to do new transactions in markets that we are having problems with.

One other piece of background. In the '80s, for years Eximbank mostly lent or guaranteed loans to the public sectors of the various countries for the procurement of U.S. goods and services. Our shift has now been to the private sector. This is applicable for both public and private. What had happened was that we were getting a lot of losses, and we had countries and/or borrowers who basically went into payment defaults, and we were still committing new transactions for those borrowers. We said, well, there is something wrong here, and we tried to stop doing that. In fact, in some cases we disbursed our loans over a long period of time, we tried to stop disbursements.

You tell the exporting community in the United States to stop manufacturing and stop your deal because we are worried about our money, they want that export to go out, they feel they have a commitment. So it was really a problem. So what we did, we turned on a water faucet, we would go on, we would go off. People were very upset, and we had one transaction that I can think of, which was about a half a million dollars, in which just after 10 percent of disbursing, the country which was Argentina at the time, was in big trouble, and we stopped disbursing.

Well, you can understand that Senator Hienz, may he rest in peace, was very upset. His constituency was very upset that we stopped disbursing, but understood that we have to be repaid for these transactions. Eximbank is not an aid agency, we do try to have a reasonable assurance of payment, try to balance the taxpayer and the exporter, our customer. This took three years to put together. So we said, a lot of times, payment defaults are just technical in nature, and when do we really ring the alarm? Maybe that we are having problems with exchange, because we are talking about international transactions.

Maybe there is a temporary cash flow problem in a country, or a particular borrower's cash flow, maybe they just need a little time. And what threshold will we do? Our transactions run to the billions of dollars, but we care about something as low as 50 thousand dollars. So what we did is we basically had an ad hoc policy that we would look at it, and we would talk about it, we said, we need to formalize that. The exporting community needs it, we need to do it.

We need to give the borrowers a message that we want to be repaid. Just because we are the United States Government, that doesn't mean we don't need to be repaid. And during the debt crisis we re-structured a lot of debt, and we are being repaid. And there are the sad situations where some that have to be looked at, as far as written down, but we try to think that we can collect all. As we are going into the mode in the '90s, to do more private sector, just to give you a little flavor, 80 percent of our bulk of business was public sector in the '80s, 80 percent is private sector.

We have a lot of private sector transactions. All the more reasons we need to have a system to monitor our payment defaults. So we decided, how can we do this? We want to make the exporting community buy into this, so we vetted this out, we worked with the exporting community, the banking community, and said, please understand our needs, and so what we decided to do, first we established a threshold. I have something up there now, if you can see. But we basically said, there are a couple of risk categories, and we will get to page two, explaining the actions. But we looked at the risk categories, and we took the high risk, and we took private sector transactions, and we thought, well, those we don't want to wait more than 90 days, because after 90 days it may not be technical in nature.

The amount of money went for a long time, and we thought, 50 thousand dollars. And so what we decided that when our agreements require the parties to report to us payment default in a guaranteed sense of the transaction, on a short transaction, on a direct loan program, we will know exactly when it is in default anyway. So what we do is that after 90 days, depending on the risk category -- we defined it for the public as factions made for the public on exposure fee levels, but it is targeted to other interest ratings -- we decided that after 50 thousand dollars, 90 days, we will take certain actions. We will turn the page in a minute to get those actions.

We thought at 150 days, that might be even worse, and then the low risk transactions, 150 days, there is a real problem. At 180 days, we said, that is too much, we cannot wait any longer. We are going to have to stop disbursements. We will get into the actions in a minute. That doesn't mean we are not collecting from day one. I just want to get that clear, because when I vetted this around, it was, what are you doing? We are trying to collect. That first 90 days gives us an opportunity to talk to the debtor and say, what is going on, what kind of problem is this, do we really have a serious problem?

We don't want to commit new transactions, we have disbursements going on. In the early '90s we were caught in an awkward position in some African countries where we were off-cover, we weren't doing business in those countries, but we had credit still disbursing. We were questioned, what are we doing, why are we still disbursing money in those countries? And when we tried to react, we found that the exporting community said, wait a minute, I did this, I shift this, you can't just cut us out.

So we said, we need the exporters, we need our customers involved. So we said, how do we do that? So we said, 45 days after we hear a default, we will contact our customer, our exporters. Now, it is hard, we have hundreds of hundreds of thousands of transactions, different parties involved, different exporters, and we have a very limited staff. What we try to do is the best, and we said, well, in order to do this, we are going to have to set up a structure. Well, that is creating more jobs in the agency that, you know, we are trying to slim down. So we said, not really, we can do this very efficiently.

Fortunately we were able to do it where we had just a handful of people

who worked in my unit, and in the Treasury Controller's Unit, and we basically have developed a system where all the reporting is centrally located. To some of you it might not sound like rocket science, it is a lot of transactions we deal with, hundreds of institutions, and paper does go all over the place. We have it in one place, these people compile the information, and then we have to -- well, who is going to do anything with this? Okay, well, that is another problem. So we developed a committee.

Again, another committee? Well, I heard the Chairman of our bank and the Vice-Chairman, some of the Directors said the best run committee meetings only last two or three minutes, some last 30 minutes, but it is very organized, because it is either technical, it is not what the rules have set out, and we have a default committee. We say, well, who is going to sit on it? If it is just myself, I'm going to stop all business, and that is not good for exporting. So we have a group, a representation from the people who lend the money, the CFO's office, and our country risk people.

It is hard because of the action codes, but I'll give it to you. You can see where the action codes of the review for the default committee actions had 90 days to determine whether the event was administrative or technical. So what happens is that the committee looked around and said, well, yeah. Somebody comes in, presents something to the committee, says, this is going to be paid next month, so we watch it. At 45 days, if that is not resolved, notices go out to the exporting community, and anybody related to transactions in that particular country, or in the case of the private borrower, with that particular borrower. We tell them, we might have a problem so that the exporting community's on notice that we will stop disbursements, that we could. As you go down here, our action code increases as the default gets worse. Suspend issuances of all letters of interest.

It is a marketing tool we've used to show that, you know, we could be available for the exporting community. Suspend authorizations of pending applications for final commitments, suspend amendments, suspend actions under operative authorized transactions, except Letter of Credit (LC) approval, which we commit under LC's, and we can't stop LC's. Suspend program -- then, of course, one of the things, I think it might have been on the first page, was after 180 days, if they are still in arrears, and we weren't able to collect it, what we will do is we will present a paper to the exposure management committee, with our country risk people, and we will seriously consider, in the case of a country, to go off cover.

That is outside the ICRAS process, and the ICRAS process establishes the ratings, and then we are on country, but we do that twice a year, but we will go. Already, just to give you some examples of, I think, successes, and Ray was concerned about this, but this committee, as I said, works efficiently and we were all concerned, so we got that past everybody. But, moreover, we in two countries, Costa Rica and Ecuador, we actually recommended to go off cover. We had arrears that went back to the early '90s, one country in the late '80s, and this was nothing that the Paris Club could resolve.

Because the appetite for the exporting community, and the appetite of those countries that wanted to do business, and their own financial house is in order, they've paid, we are back on cover in those two countries, and we have no more arrears. We have helped clean up the arrears. My division can only do so much if you don't have the power -- if you are off-cover, and you do no business with the country, it is hard from sovereign to sovereign, after you've been through the Paris Club. So it has been an extra tool beyond the Paris Club, which is our forum to work on sovereign debt, because we cannot restructure sovereign debt outside of any other forum.

On private debt, it has been fantastic. We don't have those problems, we get paid right away, there is an awareness. The exporting community is really happy that they can get a notice because maybe they don't want to do business with these people. I think what we really feel is, this works, and it has given us some things that I thought, you know, my department was responsible for those collections, couldn't do, because we needed the whole bank, we work as a team in the bank, so we are a corroborative effort, everybody is involved in the process, we are all in the same, and we all have that same goal.

If the country is credit-worthy, if the borrower is credit-worthy, we want to do business because of one reason, to get exports, and obviously to sustain or create jobs in the United States. So I think it worked, it is one of our more successful, and it has given us the opportunity to do a lot of understanding and due diligence that we hadn't done before, unfortunately. I think we are at the stage, now, where the debtors, if I can use the word debtors, borrowers, know when, in fact some of them know, just at the 89th day, they pay. Which is a little problem.

I think we are not the water force that we were, and we are giving the best value to the taxpayer and doing the best we can for the exporters.

MODERATOR STANTON: Thanks, Jeff. I've got a couple of questions, and let's throw it open. My first question is really a point of information. It is 100 percent guarantee that Exim gives to a loan?

MR. MILLER: That is right.

MODERATOR STANTON: What would happen if you structured a loan and gave a sweeter price that was 10 percent guaranteed by the bank, would that protect you at all against the possibility of default?

MR. MILLER: In the '80s we had risk sharing, but it wasn't pure risk sharing. You know, they laid it off, the banks would never hold it in their portfolio, they collateralized it, they did what they needed to do. But because of the current environment, downsizing, we are now revisiting risk sharing. I don't think it has the effect on defaults, other than credit standards, they probably, if their own money is at stake they are going to do a little better job with the credit standards, but moreover, the pricing. We want to try to make it as

attractive as possible, and it helps on the pricing, it helps to know that we are in with the borrower.

In a way, yes, because we are doing it better, we get a better class of borrowers, and that is definitely being contemplated as we go into exploring delegated authority and things like that, partnering with the private sector in order to get them to help us. I think our initiative is really, this is their program, we are there for them, but yes, I think that would be -- it would help so many different things.

Then we would also be able to feel more comfortable in delegating. So the fact that they can see less bureaucracy, Eximbank, they get better pricing, and we get a better borrower. I think that is the way, and I'm really involved in that process, right now. We are talking to different groups in town.

MODERATOR STANTON: Second question is, with respect to the borrowers, which are the subject of default policy in here, we have in the room Tom Stack, who is sort of the father of something called CAIVRS for the loan programs like SBA, student loans, HUD individual mortgage loans.

There is a process where federal agencies will exchange information so that if you default on your student loan you can't get an FHA or VA mortgage, something like that. I'm just curious whether you share with OPIC, for example, that may deal with the same class of borrower, whether there is any advantage to coordination among different agencies of the Federal Government?

MR. MILLER: A couple of things on that. First, on the OPIC part of that, OPIC and Eximbank, pretty much have acted separately until the advent of project finance, we are very, you know, we have similar projects, we are involved in similar transactions for different things.

We are focused on the goods and services, and they are focused on investment. And we do see ourselves sharing, and apparently we are being put in the same group as them. But as far as the overall, I mean, the Debt Collection Improvement Act, which you know, for years we have, as doing international collections, versus the domestic, we just, you know, have not been party to this.

The Debt Collection Improvement Act has put us in. We are discussing with OMB and the other agencies our role in this, now, because we are basically -- purposes. One of the things that we don't want to lose, whether we still pursue our own collections or what have you, is that we don't want to lose this. In the '80s we found the value of that, we pursued it, but we were, oh, well, you can't do this. I mean, we can't -- because we found people who owed us guaranteed transactions in Venezuela, Mexico, and other countries that had large assets in the United States.

With the help of sister agencies, we could have had bigger successes. So I welcome that, and we are going to be pursuing that as far as sharing information. Just recently I got a phone call from the IRS, so I guess it is working, because we got a phone call from the IRS saying, are you going to pay that claim?

So it is working, and I think it is great. And I want to join in on it. Right now we are just finding out what our role is vis a vis the Act, and to what extent. We do also have a program which is our Working Capital Loan Program, which we basically guarantee working capital loans to small businesses in order for them to generate exports. If that defaults, a borrower is a U.S. company, and that is a U.S. domestic side. So I see some real synergy in the Act for us, and things like that, and we are in the middle of talking to OMB and Treasury.

MODERATOR STANTON: Great. I was just thinking in the concrete. Do you send OPIC notification of your borrower list that are affected by the default policy?

MR. MILLER: No, well, we are trying to explore, there are legal concerns about putting out lists. One of the things we talk about in delegating authority, if they have to ask us about borrowers, what is the sense of -- what is delegated authority about, they have to come in, anyway.

So we are spending a lot of time trying to figure out if we can do it. The problem is that to call them bad borrowers and things like that, our General Counsel's Office is concerned about some of the labels we put on. In the delegated authority context you are talking about, borrowers, the delegated authority is not available, you have to come to us for any questions. But I'm not sure. If there is anybody, sister agencies that know more about that subject, we'd be interested in that.

MODERATOR STANTON: Sure, the legal framework may be different, and as a lawyer, I will always -- but let me say that, for example, FHA and HUD has delegated underwriting, and there is this process where the agencies, actually the mortgage banker, in a delegated underwriting, can tag in with the proposed borrower, and find out whether they get a hit on a match with respect to defaulted borrowers in other programs. So there is something there that works.

MR. MILLER: It does. But the type of borrowers we have, at this point, even though we don't borrow in the private sector, they are corporate, the days of the personal guarantees are faded, so they are foreign entities, foreign countries. In the U.S. it would be those -- and the Justice department gets pretty involved pretty fast, because most of them, unfortunately, go into some legal protection. The Justice Department who we work through for our litigation in the United States, is very aware of that.

I'm sure that they are putting in systems that they need to. The other would be people who possibly defraud us. Again, we go through the Justice Department for that. So they must have a universe of names, if they are tapped into this, already and that is probably where the IRS became involved.

MODERATOR KESTERMAN: Are there other questions? Are there Advocates inside or outside the government to try, who would bend the rules a little bit?

MR. MILLER: Our own exporting community wants to do the deal with the sovereign entity, and you know, unfortunately, this hasn't been as problematic as years past, because the government, on an agency group basis, through the ICRAS process is together on this. I think they might have their fights at the community level, but every agency has their own cover policy. But yes, we have had a lot of pressure, and they have their embassies, they have their groups, and they try to do that. So yes, they do have some groups. We very rarely, I mean, sometimes -- but we try to look at, first of all, if we are not on cover, and things like that, certain things are just non-starters.

To the extent that we can do something, you know, they might structure it differently, maybe they will do it -- in this day and age we are trying to structure things, we are trying to make it happen.

At the end of the day, as much as we want, you know, looking at this default policy we are asking, or looking at the reasonable assurance of repayment, we want those exports to go forward, but not at no risk, or risk. We need to know we are going to get repaid. So yeah, they do. They come into --

MODERATOR KESTERMAN: So you listen a lot.

MR. MILLER: And a lot of times what we will have, and which is very interesting, talk about assistance. We had in the late '80s, and just recently again it is happening, where the exporters are going to the government, you didn't pay X, and the bank that is holding this transaction up, because they are out there collecting for us, that is okay. I guess, you know, if it is going to make their transaction, but, you know, we've got to look at what happened and make sure it doesn't happen again.

I mean, we just can't clear it up and go back, and that was the problem. We have another paper which I didn't bring is, what to do with a country that goes off the default policy? Especially like Costa Rica and Ecuador. We want to see some payment performance, so



we wait for the next couple of maturities on any new transactions, and then we see.

Eventually we have to say, okay, it is time to go back, because the exporting community is just all over us. There is a big appetite out there.

PARTICIPANT: In the Student Loan Program, the Department of Education, where the school is partially responsible for the student loan default rates, the first part of my question is, is there any link between quality service your customers are providing and the payment rate, and if so, what are the other incentives for your customers to convince these borrowers to repay their loans, other than just -- are they taking proactive steps?

MR. MILLER: I think the exporting community just wants to do the deal and we want them to do the deal. So they will do things, they will hire Counsel, they will find creative ways to structure it, so that maybe we are not taking the risk of that company. For years, you know, we've been accused of Boeing's Bank, but we found that we do a lot of that asset base, now. Especially now that we are going to the private sector. In markets where we are a little uncertain, where we've had some experience like this, we'll do it, we'll look at the assets. So they are coming in, they are being creative, we are being responsive. We are trying to be creative too, but they are out there with the resources. But yes, there are ways, and it is all driven by the customer, and I think the more creative they are, and the more understanding, I think part of the problem with this is the understanding of our policies, which now is written and easily understood.

I think with that, these people at least now know the rules of the game. I think that was the problem, we were just telling people, well, we'll do it. You know, we need some consistency, and we just have to be open about it.

MODERATOR STANTON: If I heard a variant on that question it would be, does good or bad servicing make a difference in whether you get paid, and what is your relationship with respect to the servicing of the loan you guarantee?

MR. MILLER: It is by program. We have, as I mentioned, we have an insurance program which is a conditional guarantee or insurance, and we have the guarantee program, and your direct loan program. And the exporters just have to be there for us, and give us the documentation. The guarantee program is an unconditional guarantee. So we look at everything up front, so that helps. They are just complaining we don't move fast enough. In fact, I just came from a seminar which was talking about that. I think that is where they could be very helpful and help themselves. But I see -- our insurance program, which is a conditional guarantee, an insurance policy, and all these other things, and they have their own documentation, so they have to come in.

If they do a better job, you know, they'll get a client that pays. Unfortunately we are looking in our insurance policies, right now, but our denial rate is a little high.

I think what we need to do is, again, we need to have more clarity and make things more friendlier, and teach what we want, you know, so that we don't interfere with their business. Because the problem, we don't want to be in a position, you know, their sales contracts, we don't want to get into all that. We just want to make sure they have credit, we get repaid, and we are protected. In the guarantee program, since we looked at all the documentation up front, if anybody didn't do the job, it is us.

So that is why, because they'll service it, they'll do whatever. When it defaults, we want to know, because that is when -- we found from the '80s that we get involved too late, the debtor is gone, especially in the private sector transactions out there, in the foreign countries. I mean, we just need to get involved early, and when you have multiple transactions from the same borrower, it is time to have those people talking to each other. It is not in this fact sheet, but the policy is clear, and that goes into my department, specifically. We have five days, because most of the guarantees on the long-term transactions have five day grace, you know. But after five days we send notices, there is another 15, 30 day period.

Under the guarantee program, the bank that we are guaranteeing, is eligible to file a claim at that point. And by 45 days we are talking. I would say that after two weeks under the loan program, and 45 days under the guarantee program, we know exactly what is going on with that borrower, we know why there is not a payment, and if it is not a technical, we are talking about our next course of action. Providing we have a claim, or in the case of a direct loan, we are taking action. In our asset-based deals, we wait five days before we think about seizing aircraft.

We are being a little more aggressive. The world environment is knowing it, because we have to. Otherwise we are going to have the same situation and that is why this committee only lasts sometimes 5 minutes -- they know us, they know what we are going to do, they know what the impact is.

To the extent that they want to do business with U.S. exports again, might have a shade of, you know, it is not exporter friendly, but this is the side of the house that takes care of the taxpayer. As I said, this ICRAS process, as many of you know, establishes the country rate. And actually Eximbank chairs the -- well, not chairs, it is the coordinator, I think it is. There is a coordinator for the ICRAS process, and by our country risk, our country risk people take that information and exposure management committee makes the presentation to the Board of Directors, that is basically all they really do.

We increased the role by saying, before we go to the Board of Directors, we want to run it through the body that decides on the cover policy, okay? So what

we are saying is, that we don't want to do business in this country, but we are not the people who make those decisions. We are the staff level, a vehicle of exposure management committee, but they are the body that just basically decides what our cover policy is because there are many countries where government is open for business, but not necessarily Eximbank or vice versa.

Or they'll say, with restrictions, or only short term. They are the ones that establish our cover policy and all the conditions under our country limitation schedule.

PARTICIPANT: You were talking about OPIC and Eximbank. Do we need both of them?

MR. MILLER: I think we are going to find that out in the coming years, so I don't want to get into that discussion. I work for Eximbank, that is all I can say and we sustain jobs in this country.

MODERATOR KESTERMAN: Well, thank you to Jeff and Kathy, worlds apart, for outstanding roles, and thank you very much, a great presentation.

(Whereupon, the above-entitled matter was adjourned at 4:28 p.m.)